**By Email Submission**

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**RE: CCI's Public Comment on the FSTB and HKMA Consultation Paper on the Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong**

## I.    Introduction

The Crypto Council for Innovation ("CCI"), a global alliance of industry leaders in the digital assets space, appreciates the opportunity to provide feedback on the FSTB and HKMA "Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong" ("the Proposal"). CCI members span the crypto ecosystem and include some of the leading global companies and investors operating in the industry. CCI members share the goal of encouraging the responsible global regulation of crypto to unlock economic potential, improve lives, foster financial inclusion, protect security, and disrupt illicit activity. Achieving these goals requires informed, evidence-based policy decisions realized through collaborative engagement between regulators and industry. It also requires recognition of the transformative potential of crypto in improving and empowering the lives of global consumers. CCI and its members stand ready and willing to work with the FSTB/HKMA and its members to accomplish these goals and ensure that the most transformative innovations of this generation and the next are best allowed to flourish around the world.

To this end, we applaud FSTB and HKMA for taking important first steps in crafting a regulatory regime for stablecoin issuers in Hong Kong. CCI broadly supports the Proposal's approach of introducing a new piece of legislation to implement the regulatory regime for FRS issuers. To further encourage international stablecoin issuers to operate in Hong Kong, we recommend the establishment of an equivalence framework that would allow well-structured and regulated operators from other jurisdictions such as the United States to distribute and market to the Hong Kong public. Similarly, regulatory requirements on capital and reserves should be in-line with those across other jurisdictions to facilitate the operations of global stablecoin issuers in Hong Kong. This will allow for improved harmonization of standards across jurisdictions focused on fostering responsible innovation and providing clear requirements to best protect consumers and investors.

As the FSTB and HKMA look to future phases of the stablecoin regime, CCI wishes to respectfully highlight algorithmic stablecoins as an important category of innovation meriting its own set of narrowly tailored guardrails and related requirements. Being natively on-chain, algorithmic stablecoins that are overcollateralized with exogenous collateral have the potential to increase efficiency within decentralized finance (DeFi) and provide users with an alternative means of payment. The combination of real-time auditability and automated liquidation systems further provide a digitally native means of risk management that should be taken into account. A failure to consider the benefits of responsibly facilitating crypto innovation may result in overly restrictive regulation that risks stifling its appropriate development and may run counter to the FSTB and HKMA's ultimate goal of promoting regulatory consistency.

Against this backdrop, we provide feedback below on key topics that cut across several of the Proposal's Recommendations and questions. CCI's feedback centers on advancing regulatory frameworks that enhance both investor protection and market integrity while fostering responsible innovation built upon crypto technologies.

## II.    Reserve Requirements and Regulation

Should Hong Kong accept internationally regulated, well-structured stablecoins, it would need to manage potential conflicts across jurisdictions to avoid imposing outsized burdens on global stablecoin operators. For example, the capital requirement should not be duplicative of the issuers' requirements in other jurisdictions, and reserves should not be required to be in Hong Kong. Instead, HKMA could follow the Monetary Authority of Singapore's (MAS) approach to allow reserves to be held offshore provided that the custodian has a branch or point of contact in Hong Kong. CCI further recommends the establishment of an equivalence framework that would allow regulated stablecoin issuers from other countries that follow similar principles as proposed by the HKMA, such as the United States, to be distributed and marketed to the Hong Kong public. In addition and to further the spirit of regulatory consistency, CCI recommends HKMA to follow the approach taken by the Japan Financial Services Agency (JFSA) to recognize issuers' licenses in other countries, subject to the explicit approval of the JFSA.

Regarding capital requirements, CCI believes that a well-regulated stablecoin that holds only high-quality liquid assets denominated in the same currency as the FRS, held in segregated accounts with monthly attestations, is a low-risk instrument. Instead of a fixed figure, HKMA should take a risk-based approach with regards to the issuer, taking into consideration the market risk of the reserve and the operational risk of the issuer.

CCI additionally supports the option for FRS collateral assets to be held, at least in part, in other currencies such as USD–given the HKD is already pegged to the dollar. This could increase the chances of stablecoins becoming commercially viable as assets in another denomination may yield a higher return without exhibiting a greater risk of loss. Allowing the retention of interest from the backing assets will improve the commercial proposition for stablecoin issuers, thereby supporting the growth of a stablecoin ecosystem in Hong Kong.

CCI agrees with the Proposal that regulated stablecoin issuers, insofar as the types of roles that such firms employ, are sufficiently different from other regulated securities and SVF entities and should therefore be excluded from certain existing regulatory regimes.

## III.     Operational Requirements

CCI supports the use of third parties (sub-custodians) as these are important in global custody models. We appreciate the risks that the HKMA is concerned with, and agree that due diligence requirements would mitigate such risks while also realizing the benefits brought about by sub-custodians, including more choice, lower cost and potentially greater protections for investors.

CCI is supportive of robust, comprehensive frameworks to target and eradicate financial crime across the whole digital asset ecosystem. By encouraging a safe, legitimate environment for all cryptoasset activity, regulators both in Hong Kong and globally can help build trust, thereby allowing growth of, and further competition within, the ecosystem.

CCI further agrees that using the existing financial crime framework is a sensible place to start. As further policy detail is developed, this framework may need to be amended in certain places to ensure the policy outcomes are met in the specific context of stablecoins. For example, ensuring that AML/KYC checks are happening in practice at on and off ramps, and that transaction monitoring and other surveillance required of firms takes account of the underlying technology. Certain blockchains have built-in Know Your Transaction (KYT) and Know Your Address (KYA) monitoring capabilities, such as Solana's Transfer Hooks.[1]

Regarding redemption requirements, we recommend clarifying section 6.2.8 to be consistent with the subsequent section, 6.2.9. Currently, 6.2.8 may be interpreted such that issuers would be required to provide redemptions of *all* users. As written in section 6.2.9, this obligation should occur only "where channels for FRS users to exchange their FRS [...] become unavailable (e.g. in the case of disruption to an intermediary or infrastructure)."

Taking into consideration the global nature of many cryptoasset businesses, ensuring that there is a physical presence of senior management and key personnel in Hong Kong may be a challenge. This relates to the point of de-conflicting jurisdictional requirements raised in the previous section.

## IV.     Additional Considerations: The Importance of Algorithmic Stablecoins

While CCI appreciates that this proposal does not extend to algorithmic stablecoins, we would like to respectfully propose additional considerations for the next phases of stablecoin regulation to best allow Hong Kong to be a forward-leaning jurisdiction focused on consumer protection.

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[1] *See*
https://spl.solana.com/transfer-hook-interface#:~:text=The%20Transfer%20Hook%20Interface%20is,the%20Transfer%20Hook%20Extension%20Guide.

Stablecoins, including those that are pegged to fiat currencies, can be designed in a variety of ways. The potential application of the Proposal's reserve asset requirements to algorithmic stablecoins would effectively ban them—the best of which operate through over-collateralization by exogenous collateral of large market cap cryptoassets—and unintentionally signal hostility toward web3 applications that rely on algorithms to develop products and services.

CCI is aware that the HKMA views crypto asset-backed stablecoins as distinct from algorithmic stablecoins, but for the purpose of future regulatory consideration we include the following information about the benefits and risks of what are broadly considered algorithmic stablecoins by the industry. Algorithmic stablecoins have a number of highly beneficial characteristics. For example, because algorithmic stablecoins rely on assets that exist natively on a blockchain, they are generally free from off-chain counterparty risks that can arise from custodying assets with third parties, like banks (which, for instance, may be constrained by their hours of operation). Without third parties, algorithmic stablecoins can achieve true decentralization and provide users with alternative payment instruments. Additionally, as a natively on-chain form of payment, algorithmic stablecoins with automated liquidation mechanisms and real-time auditability can provide greater transparency for risk management to its users.[2] It is important to note that many of these benefits derive from the extent to which algorithmic stablecoins are decentralized in practice. To determine how decentralized an algorithmic stablecoin is, CCI recommends regulators to determine whether it meets certain decentralization thresholds such as that collateralization ratios cannot be changed in the absence of a decentralized governance process.

While algorithmic stablecoins also pose certain risks, those risks are distinct from those of other types of stablecoins and we hope that, in future rulemaking, stakeholders will calibrate rules accordingly. Not all algorithmic stablecoins are the same, and generally what determines the risk with respect to a particular algorithmic stablecoin should be focused on how much and what type of collateral is required by the protocol to support the price of the stablecoin.

CCI defines algorithmic stablecoins as algorithmic cryptocurrencies that (i) peg their value to a fiat currency, (ii) are collateralized by digital assets such as crypto tokens, and (iii) are governed by algorithms that are designed to dynamically ensure adequate levels of collateral and reduce the price volatility of such stablecoin. Over-collateralized stablecoins backed by exogenous assets have demonstrated a high degree of resilience to market shocks, and have exhibited relatively low risk. Algorithmic stablecoins that require overcollateralization using high quality collateral like Bitcoin and Ether remained stable and functioned uninterrupted throughout the recent downturn. Examples of this category of stablecoins–which, as defined above, are collateralized by digital assets such as crypto tokens–include DAI,[3] RAI,[4] and LUSD.[5] By ensuring that the protocol always retains collateral in excess of outstanding stablecoins, and that this collateral is exogenous, over-collateralized algorithmic stablecoins can achieve a

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[2] *See, e.g.,* Reflexer Stats, https://stats.reflexer.finance/
[3] *See* MakerDAO, https://makerdao.com/en/.
[4] *See* Reflexer, https://reflexer.finance/.
[5] *See* Liquity, https://www.liquity.org/.

degree of safety commensurate with fiat-backed products. Therefore, well-tailored stablecoin regulations should take into account the amount and type of collateral being used.

CCI appreciates this opportunity to provide a summary of the differences within the stablecoin category to highlight why algorithmic stablecoins should be considered separately from FRS as a technologically innovative alternative stablecoin mechanism that merits a tailored regulatory approach. We welcome opportunities to provide further input and would encourage the FSTB/HKMA to conduct a study analyzing the relative safety of over-collateralized algorithmic stablecoins.


### V.    Conclusion

It is critically important that regulators and policy leaders thoughtfully regulate blockchain and stablecoin technology, as it is rapidly becoming a key pillar of the financial system. CCI greatly appreciates the opportunity to provide comments on these important matters. We view this comment letter as part of an ongoing dialogue between the public and private sectors and look forward to continued engagement on these issues. CCI and our members will continue to work closely with FSTB and HKMA on future VA consultations and support Hong Kong policymakers in advancing progressive regulation.

Respectfully submitted,

Crypto Council for Innovation (CCI)