



Policy Statement on Development of Virtual Assets in Hong Kong

This statement issued by the Financial Services and the Treasury Bureau (“FSTB”) sets out the Government’s policy stance and approach towards developing a vibrant sector and ecosystem for Virtual Assets (“VA”) in Hong Kong.

Our vision and approach

2. As an international financial centre, Hong Kong is open and inclusive towards the global community of innovators engaging in VA businesses. We applaud the achievements of the community in pioneering distributed ledger technologies (“DLT”), and in developing new financial innovations aiming to be more cost-efficient, inclusive, agile, and future-proof. We recognise VA is here to stay, given how it has attracted attention of global investors and is increasingly viewed as a conduit for financial innovations, not to mention the future opportunities that will be opened up as VA moves into the areas of Web 3.0 and the Metaverse. The Government, in conjunction with the financial regulators, are working towards providing a facilitating environment for promoting sustainable and responsible development of the VA sector in Hong Kong. We are ready to calibrate our legal and regulatory regime as part of our effort to provide the aforesaid facilitating environment having regard to the evolving nature and innovative approach of VA.

3. We recognise the potential of DLT and Web 3.0 to become the future of finance and commerce, and under proper regulation they are expected to enhance efficiency and transparency, which in turn will reduce or resolve existing frictions

across clearing, settlement and payments. Hong Kong shows signs of a vibrant VA ecosystem, as demonstrated by NFT issuance in our market, presence of Metaverse developers, and use of DLT in trade finance etc. Further opportunities can be realised if we cast our sight further on more use cases, e.g. trading arts and collectibles, tokenising vintage goods, or in the case of financial innovations, tokenising a wide spectrum of products such as debt securities.

4. Similar to the development and adoption of other technologies that came before, pathway to the above vision may not be straightforward as it involves considerable risks in uncharted waters. We will adopt the “same activity, same risks, same regulation” principle, and put in place timely and necessary guardrails, so that VA innovations can thrive in Hong Kong in a sustainable manner, while actual and potential risks on financial stability, consumer protection, as well as money laundering and terrorists financing can be mitigated and managed in line with international standards. Given the status of Hong Kong as an international financial centre and the global reach of VA, we also need to monitor the international regulatory developments closely, which are gathering pace and momentum, and take them into account in the development of our regulatory system.

Regulations

5. Over the past few years the Government and the regulators have developed a comprehensive framework for the regulation of VA activities, under the “same activity, same risks, same regulation” principle. A regulatory regime has been launched to license VA Exchanges using an “opt-in” approach, and on the asset management front guidance has been issued on management of VA funds and discretionary accounts. Also, banks and financial institutions have been provided guidance on distribution of VA-related products, dealing in or advising on VAs. These comprehensive regulatory regimes have been well received by the industry. With

consistency, predictability and clarity gradually established by our regulatory framework, we have a solid foundation to further embrace financial innovations and technology development brought by the rapid development of VA globally.

6. To take the aforesaid comprehensive regulatory framework further forward, our latest effort is to put together a licensing regime for VA Service Providers. The new regime will align requirements for VA Exchanges in terms of anti-money laundering, counter-terrorist financing (“AML/CTF”), and investor protection to those currently applicable to traditional financial institutions, hence offering licensed VA Exchanges the status and credibility to access a wider net of investors in the Hong Kong market. An additional benefit is that financial intermediaries and banks will be able to partner with licensed VA Exchanges when offering clients with VA dealing services, provided that relevant regulatory conditions are met. From the perspective of VA Exchanges, a licensing status will offer them the potential to open new distribution channels in Hong Kong, tapping into our sizable asset and wealth management market which is worth over US\$4.5 trillion. And VA Exchanges can also further tap into our established financial markets through the connectivity with traditional financial institutions. As we step up our preparatory work for the new licensing regime, we are ready to engage with global VA Exchanges and invite them to set foot in Hong Kong for new business opportunities.

Investors’ exposure to VA

7. We recognise the increasing acceptance of VA as a vehicle for investment allocation by global investors, be they institutional or individual. While the Securities and Futures Commission (“SFC”) will be conducting a public consultation on how retail investors may be given a suitable degree of access to VA under the new licensing regime, we note that retail investors in other markets have also been given exposure to VA via VA-related products such as Exchange Traded Products. Hong Kong is

therefore open to the possibility of having Exchange Traded Funds (“ETFs”) on VA in Hong Kong, and soon the SFC will publish a circular on this. Having these products launched in Hong Kong will provide the connectivity between VA players and traditional financial institutions, offering investors with well-designed products, hence promoting the overall growth of the sector in our market. That said, we will be careful and cautious about the risks to retail investors, and therefore will enhance investor education and ensure that suitable regulatory arrangements are in place.

Property rights of tokenised assets

8. We recognise VA have unique characteristics different from traditional assets, and their features may not fit squarely into the current private property law categories or definitions in Hong Kong. To facilitate adoption and enhance investor protection, the Government is open to future review on property rights for tokenised assets and the legality of smart contracts, so as to provide a solid legal foundation for their development.

Stablecoins

9. Another key area of focus is stablecoins. On the basis of their purported certainty in terms of maintaining value stability and increasing use cases e.g. as a means of exchange between cryptocurrency and fiat currency, stablecoins are seen to have a growing potential for significant interconnectedness with the traditional financial markets e.g. in the payment system. With lessons learnt from recent crisis in the VA market (Crypto Winter), international consensus is to put in place appropriate regulations on aspects such as governance, stabilisation and redemption mechanisms of stablecoins. In this regard and early this year before the Crypto Winter, the Hong Kong Monetary Authority (“HKMA”) already issued a discussion paper on the subject, seeking feedback on putting in place a risk-based,

proportionate, and agile regime for regulating activities relating to payment-related stablecoins. Consultation outcome and next steps will be announced in due course.

Our pilot projects

10. The Government and the regulators are exploring the following pilot projects to test the technological benefits brought by Virtual Assets and their further applications in the financial markets. These demonstrate our commitment and determination to explore financial innovations together with the global VA community.

- (a) **NFT issuance for Hong Kong Fintech Week (“HKFTW”) 2022**: A proof-of-concept project on our part to engage the Fintech and Web3 community;
- (b) **Green bond tokenisation**: Tokenising Government Green bond issuance for subscription by institutional investors; and
- (c) **e-HKD**: The potential “backbone” and anchor bridging legal tender and VA, offering price stability and confidence needed to empower more innovations.

Further details on the above pilot projects can be found in the Annex.

Conclusion and way forward

11. With Hong Kong’s world class financial infrastructure, legal and regulatory regime, we aim to promote the sustainable development of financial services across the whole VA value chain, covering issuance of VA, tokenisation, trading and settlement platforms, financing and asset management, and custody etc. The Government is prepared to embrace the future of finance and commerce, supporting the underlying technologies of VA and promoting their benefits in our market, and

we welcome the clustering of Fintech and VA community and talents in Hong Kong. The vision presented in this policy statement will be achieved by facilitating policies, comprehensive and balanced regulations, risk-based guardrails, as well as our pilot projects. The Government sincerely invites the global VA community to join hands with us and leverage on Hong Kong's status as an international financial centre to realise the potential of financial innovations under a clear, agile and facilitating regulatory environment, adhering to best international standards and practices.

31 October 2022

Financial Services and the Treasury Bureau
The Government of the Hong Kong Special Administrative Region

Annex: Pilot projects to test the technological benefits brought by Virtual Assets and their further applications in the financial markets

NFT issuance

1. Non-fungible token (“NFT”) has proven itself to be a new form of digital ownership in recent years, and it has been harnessed by art creators and businesses around the world to create and engage with communities sharing common beliefs and goals. The FSTB, together with our investment promotion department InvestHK, have conducted a pilot project to promote the usage of NFT in our annual flagship event – the Hong Kong Fintech Week (“HKFTW”) in 2022.

2. The NFT will serve as a proof of attendance for attendees of the HKFTW, offering them a digital badge and memento using Blockchain technology in celebration of their participation. The NFT is user and beginner-friendly, as it can be stored in Crypto Wallets directly, or for those who are new to NFTs and yet to have a wallet, it can also be stored as a “NFT-to-be” using an email address and be ready for conversion into a NFT later. The NFT will be linked with exclusive experience at the HKFTW, offering holders a chance to create their own Augmented Reality (“AR”) avatar to experience the Metaverse.

3. The Government sees the NFT issuance as a proof-of-concept project on our part to engage the Fintech and Web3 community, and demonstrate our commitment in innovation. Benefits will be offered to holders of the NFT, including special discount on tickets for the HKFTW next year, and exclusive early announcements for participation in our other Fintech events including the Fintech Proof-of-Concept Subsidy Scheme sharing sessions, Fintech training programmes and other potential fast track and incubation programmes.

Green bond tokenisation

4. Bond tokenisation holds the potential to enhance the efficiency and reduce the cost in bond issuance and settlement, and could open the market to a broader investor base. Following the successful completion of Project Genesis by the HKMA and the Bank for International Settlements (BIS) Innovation Hub Hong Kong Centre, which developed two prototypes (utilising permissioned and permissionless blockchain respectively) to concept-test the use of distributed ledger technology (DLT) to streamline green bond retail issuance, the HKMA is working on a pilot project tokenising Government Green bond issuance for subscription by institutional investors. The objective is to test out the financial infrastructure and the legal and regulatory environment in Hong Kong for the use of DLT throughout the bond lifecycle (covering issuance, settlement, asset servicing, secondary trading and redemption) and to serve as a guide for similar future issuances by market participants. Further details will be announced to inform the industry and the public about progress of the project.

e-HKD

5. VA and Cryptocurrencies, despite their technological innovations, cannot serve as legal tender in Hong Kong as they are not by law regarded as valid and legal means of payment to adequately and effectively fulfil payment obligations. While we envision VA and Cryptocurrencies can still empower many financial innovations as highlighted in the earlier parts of this statement, the Government and the regulator see a space to fill in terms of exploring possible launch of our retail Central Bank Digital Currency (“rCBDC”) – the eHKD.

6. Based on earlier market consultations conducted by the HKMA, respondents are supportive of the e-HKD initiative and believe it has the potential to make

payments more efficient and support the development of Hong Kong's digital economy. The HKMA will pave the way for a possible launch of e-HKD via a "three-rail approach", exploring by phases 1) the technology and legal foundations; 2) use cases and designs; and 3) the timeline for launching e-HKD. To the global VA community, we believe the significance of e-HKD lies in its potential to serve as the "backbone" and anchor bridging legal tender and VA, hence offering the price stability and confidence needed to empower more innovations around Security Token Offerings based on different types of assets.

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