February 29, 2024

Digital Finance Division
Monetary Management Department
Hong Kong Monetary Authority
55/F, Two International Finance Centre
8 Finance Street
Central
Hong Kong

Email: stablecoin_feedback@hkma.gov.hk

Dear Sir or Madam,

Ripple Labs Inc. ("Ripple") welcomes the opportunity to comment on the consultation paper on the Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong (the "Consultation") jointly published by the Financial Services and the Treasury Bureau (the "FSTB") and the Hong Kong Monetary Authority (the "HKMA") on December 27, 2023.[1]

Ripple is also grateful for the opportunity to comment on the Discussion Paper on Crypto-assets and Stablecoins (the "HKMA Discussion Paper") published by the HKMA on January 12, 2022.[2] Ripple responded to the HKMA Discussion Paper on March 31, 2022[3] (the "Ripple HKMA Discussion Paper Response"), and we request that the FSTB and HKMA read the Ripple HKMA Discussion Paper Response in conjunction with this comment letter.

Ripple would like to thank the FSTB and the HKMA for both the in-depth and comprehensive analysis that has been undertaken in both the Consultation and HKMA Discussion Paper, and for the opportunity to provide our comments. We respectfully

[1] *See* https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2023/20231227e4a1.pdf, Legislative Proposal to Implement the Regulatory Regime for Stablecoin Issuers in Hong Kong.
[2] *See* https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2022/20220112e3a1.pdf, Hong Kong Monetary Authority Discussion Paper on Crypto-assets and Stablecoins.
[3] *See* https://ripple.com/files/Ripple_HKMA_Cryptoasset%20and%20Stablecoins_Discussion%20Paper_January%202022_final.pdf, Ripple response to the Hong Kong Monetary Authority Discussion Paper on Crypto-assets and Stablecoins.

request you take them into consideration as you consider the policy direction and scope of the intended regulatory regime for stablecoin issuers in Hong Kong. We welcome the opportunity for further engagement with the FSTB and HKMA on this Consultation and any other related consultations as may be appropriate.

1. Introduction

Ripple's software products allow financial institutions to send money globally, on a real-time basis, at a fraction of the cost of traditional services available to market participants. Using blockchain technology, Ripple allows financial institutions to process payments instantly, reliably, cost-effectively, and with end-to-end visibility anywhere in the world.

Ripple's aim is not to replace fiat currencies, but rather to enable a faster, less expensive, and more transparent method of making cross-border payments that is in the public's best interest.

2. Cross-border Payments using Ripple Payments

As highlighted in the Ripple HKMA Discussion Paper Response, Ripple believes that blockchain technology demonstrates the potential to transform many sectors of Hong Kong's economy, including in cross-border payments. However, we also believe that for any technology, success is based on its use cases and ability to solve real-world problems.

Cross-border payments are costly, full of friction and slow. Much of this friction is the result of the dated processes followed in cross-border payments, until now the domain of incumbent banks (referred to as correspondent banks). A definition cited by the Bank for International Settlements defines correspondent banking as *"the provision of current or other liability account and related services to other financial institutions (including affiliates), used for the execution of third-party payments and trade finance as well as its own cash clearing, liquidity management, short-term borrowing and investment needs in a particular currency."*[4]

As this definition highlights, banks use correspondent relationships - a network of bilateral accounts-based relationships - spread across the world to process payments. Although widely proliferated, the market structure of correspondent-banking injects significant friction, delays, and costs in processing payments for the respondent banks, primarily due to the need to prefund accounts.[5]

Ripple Payments connects hundreds of financial institutions around the world via a single application programming interface ("API") which makes transferring money

[4] *See* https://www.bis.org/cpmi/publ/d147.pdf, Committee on Payments and Market Infrastructures – Correspondent Banking.
[5] *See* https://www.bis.org/publ/qtrpdf/r_qt2003f.pdf, BIS Quarterly Review March 2020, page 31.

faster, cheaper, and more reliable. It also helps to reduce, and even eliminate, the need to prefund accounts by using the digital asset XRP to source liquidity during cross-border transactions as an alternative to traditional funding mechanisms. Ripple Payments customers can use XRP to bridge two currencies in a matter of minutes, ensuring payments are quickly sent and received in local currency on either side of a transaction. The broad Ripple Payments flow is outlined in Figure 1 below.

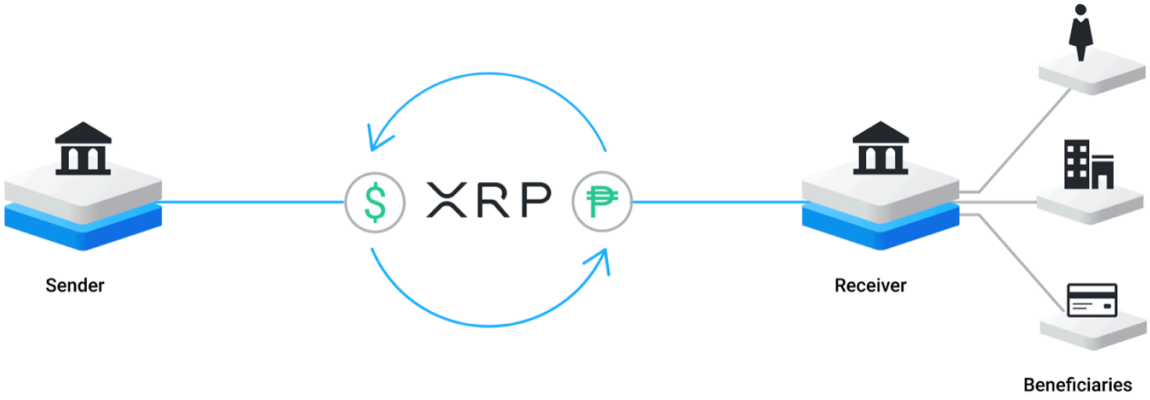

Figure 1: Ripple Payments Flow

Digital assets issued on blockchains that serve the same end-use as the incumbent correspondent banking model can offer a compelling alternative for end-users while still being compliant with anti-money laundering ("AML") and countering the financing of terrorism ("CFT") requirements. Global multilateral bodies have also recognized the potential digital assets and blockchain technology have in facilitating faster cross-border payments.[6]

3. Interoperability

Ripple believes that interoperability - achieved through alignment of national payment protocols and adoption of international standard protocols - will ultimately be core to the successful adoption of digital assets and stablecoins.

Ripple itself applies protocols to drive the efficient globalization of value through multiple initiatives with financial services and open-source communities. Ripple Payments is powered by a standardized API and built on the market-leading and open standard Interledger Protocol, enabling financial institutions to facilitate faster and less costly cross-border payments. Ripple Payments demonstrates that deep interoperability between commercial financial institutions can make payments truly efficient, particularly in eliminating the uncertainty and risk historically involved in moving money across borders using interbank messaging alone.

[6] *See* https://blogs.worldbank.org/psd/paying-across-borders-can-distributed-ledgers-bring-us-closer-together, World Bank blog.

Protocols used by global, cross-border payment networks and decentralized tools that support them should be considered and supported in this new age of domestic networks. Embracing the capabilities of these global networks, and better enabling domestic institutions to connect their individual capabilities with other systems and markets, will enable optimized outcomes for their respective domestic needs as well as fulfil the potential that globalization of value holds.

4. Issuing Stablecoins on the XRP Ledger

The XRP Ledger can also be used to support the issuance of stablecoins with a unique, fungible token functionality called Issued Currencies.[7] Issued Currencies is designed to be the ideal stablecoin platform, providing simple but rich management functionality for the issuer that makes it easy to create, issue and manage any asset - including stablecoins.

The XRP Ledger has an integrated decentralized exchange ("DEX") that allows neutral, counterparty-free digital assets like XRP to be seamlessly exchanged to and from "issued assets" including stablecoins. Among the unique features is its payment interoperability, which enables payments among those holding and receiving assets to minimize costs and work seamlessly when sufficient liquidity is available.

While neutral bridge assets such as XRP and stablecoins alike can be used to settle a payment, stablecoins have an issuer as the counterparty that does not allow them to interoperate across payment networks. XRP, on the other hand, can be sent directly without needing a central intermediary - making it best-suited to bridge two different currencies quickly and efficiently.

In terms of initiatives in this space, Ripple announced a partnership with the Republic of Palau on November 23, 2021, which focused on developing strategies for cross-border payments and a USD-backed digital currency for Palau.[8] This has seen a pilot for the implementation of the world's first government-backed national stablecoin.[9] Additionally, STASIS, an established leader in Euro-backed stablecoin production, announced on February 16, 2022 that it will issue the EURS stablecoin on the XRP Ledger due to its scalability, speed, low cost and carbon neutrality.[10] In Australia, Novatti

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[7] *See* https://xrpl.org/issued-currencies-overview.html, Issued Currencies Overview.
[8] *See* https://ripple.com/insights/featured/republic-of-palau-partners-with-ripple-to-develop-digital-currency-strategy/, Republic of Palau Partners with Ripple to Develop Digital Currency Strategy.
[9] *See* https://www.palaugov.pw/wp-content/uploads/Republic-of-Palau-Stablecoin-Program-Phase-1-Report.pdf , Ministry of Finance Republic of Palau Stablecoin Program: Phase 1 Report.
[10] *See* https://ripple.com/ripple-press/stasis-to-issue-euro-stablecoin-on-the-xrp-ledger/, STASIS to Issue Euro Stablecoin on the XRP Ledger.

announced on June 9, 2022 that it will issue the Australian Dollar-backed stablecoin AUDC on the XRP Ledger.[11]

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With this overview, Ripple respectfully submits the following responses to the discussion questions set forth in the Consultation in the attached Appendix.

Ripple appreciates the opportunity to provide feedback on the Consultation as the FSTB and HKMA study these important issues, and we would encourage and support further dialogue with all stakeholders. Should you wish to discuss any of the points raised in this letter, please do not hesitate to contact Rahul Advani (Senior Policy Director, APAC) at radvani@ripple.com.

Sincerely,

Ripple Labs Inc.

[11] *See* https://novatti.com/wp-content/uploads/2022/06/Novatti-to-issue-Australian-Dollar-backed-stablecoin-on-XRP-Ledger.pdf, Novatti to issue Australian Dollar-backed stablecoin (AUDC) on XRP Ledger, with partnership support from Ripple.

APPENDIX

Ripple respectfully submits the following responses to discussion questions 1, 2, 3, 4, 5, 6, 8, and 14 set forth in the Consultation.

Question 1: Do you agree with the proposed definition of "stablecoin" and "FRS"?

Ripple agrees with the definition of "stablecoin" and "fiat-referenced stablecoin" ("FRS") proposed in the Consultation.

Question 2: Do you have any comments in relation to the scope of regulated stablecoin activity?

Ripple respectfully believes that the scope of regulated stablecoin activity proposed in the Consultation should be reviewed in order to support innovation in Hong Kong.

Specifically, we believe that FRS for which an issuer does not meet the licensing criteria under Section 6.2(a) of the consultation (such as an FRS that derives its value from arbitrage or algorithm) should be considered virtual assets ("VAs") and be required to meet the requirements under the Guidelines for Virtual Asset Trading Platform Operators ("SFC Guidelines") issued by the Securities and Futures Commission ("SFC").[12] This will ensure that the innovation such types of FRS bring to Hong Kong will continue to be supported, and will also allow the SFC and HKMA to continue to monitor developments in the stablecoin landscape with a view to bringing other types of stablecoins within the regulatory perimeter when needed.

We also suggest that the HKMA adopt a label for such FRS that fall within the regulatory perimeter, such as "HKMA-regulated stablecoin", to allow consumers to readily differentiate between stablecoins that fall within the FRS regulatory framework and those that fall within the VA regulatory framework.

Additionally, there is a possibility that as the market for FRS develops, FRS issued outside Hong Kong may become systemically important. Therefore, in line with the principle of 'same risk, same activity, same treatment', we respectfully suggest that the HKMA adapt regulations where necessary to address any regulatory obstacles or challenges specific to stablecoin arrangements (including those issued outside of Hong Kong), whilst ensuring financial stability and the appropriate regulatory outcomes to support innovation are achieved.

[12] *See* https://www.sfc.hk/-/media/EN/assets/components/codes/files-current/web/guidelines/Guidelines-for-Virtual-Asset-Trading-Platform-Operators/Guidelines-for-Virtual-Asset-Trading-Platform-Operators.pdf?rev=f6152ff73d2b4e8a8ce9dc025030c3b8, Guidelines for Virtual Asset Trading Platform Operators.

Question 3: Do you agree with the proposed approach of introducing a new piece of legislation to implement the regulatory regime for FRS issuers, and potentially cover the regulatory regime for other VA activities as appropriate in the future?

Ripple believes that it is critical to consider that a key differentiating factor between FRS and stored value facilities ("SVFs") is that the exchange rate of the FRS to the fiat currency is not fixed, and can vary when traded on exchanges (unlike SVFs, which have a fixed exchange rate). This characteristic of FRS has been noted by the Bank for International Settlements.[13]

It's also important to note that the certainty with which FRS holders are able to redeem for fiat currency may also vary - in times of crisis, market liquidity to redeem for fiat currency may tighten.

Additionally, FRS holders can often use the FRS through third-party service providers such as exchanges or private wallets, without the FRS issuer being involved. This is unlike holders of SVFs who will have contractual relationships and accounts with the SVF issuer, and can only use the SVF through the SVF issuer.

Taking these factors into consideration, we believe that FRS are unlike SVFs in that the liability of the FRS issuer and the ability of FRS holders to redeem for fiat currency can vary. For example, FRS issuers may be able to secure trust even without the FRS holders having a claim on the issuer or redemption rights, by ensuring that a market always exists for holders to redeem for fiat currency.

To summarize, FRS exhibit the following characteristics that differ from SVFs:

a. the exchange rate of the FRS to the fiat currency it references may vary when used, traded or offered by third-party service providers; and
b. a holder of the FRS need not have a contractual relationship or an account with the FRS issuer in order to use the FRS.

This makes the risks of an FRS very different to that of an SVF, and therefore regulating FRS as SVFs will not align with the risk-based regulatory approach outlined in the Consultation.

Therefore, Ripple believes that given these differing characteristics and risks, regulation as an SVF is not an appropriate framework for the regulation of FRS issuers, and we are supportive of the proposed approach of introducing a new piece of legislation to implement the regulatory regime for FRS issuers. We are also supportive of potentially covering the regulatory regime for other VA activities, as appropriate, in the future.

[13] *See* https://www.bis.org/publ/work905.pdf, Bank for International Settlements, BIS Working Papers No. 905 - Stablecoins: risks, potential and regulation, Page 8 (Graph 2).

Question 4: Do you agree with the proposed exclusion of issuance of FRS from certain regulatory regimes, such as those for securities and SVFs, to avoid subjecting FRS issuer to multiple regulatory regimes?

Ripple is supportive of the proposed exclusion of issuance of FRS from certain regulatory regimes to avoid subjecting FRS issuer to multiple regulatory regimes.

Question 5: Do you have any comments on the proposed licensing regime for FRS issuers?

Given the cross-border nature of stablecoin markets, Ripple respectfully requests that the HKMA consider a regulatory framework that supports mutual recognition of licenses across jurisdictions. Such mutual recognition could help drive a level playing field globally, thereby supporting the sustainable growth and development of the stablecoin ecosystem. Jurisdictions such as Singapore[14] and Japan[15] have stablecoin licensing regimes which could be considered for such equivalence.

Such mutual recognition decisions exist for traditional financial institutions and infrastructures, which can be used as a template for stablecoins. Many of the regulatory and supervisory institutions for stablecoins would be the same as those for the traditional financial sector, which should foster trust and ease communication between jurisdictions.

Such an approach will also help reinforce Hong Kong's position as a global financial centre, and could help develop a more vibrant stablecoin ecosystem. However, we would also like to highlight that in making such a determination, a principles-based approach should be followed. An overly prescriptive process for a mutual recognition determination could disincentivize global firms from exploring this option.

Question 6: Do you have any comments on the proposed licensing criteria and conditions?

Ripple respectfully requests clarification on section 6.3.4 of the Consultation, as it is unclear from this section on what constitutes a "new FRS" under this requirement.

For example, a "new FRS" could mean an FRS that is economically distinct from the existing FRS, which could introduce new risks from a value stability perspective. In this case, we are supportive of the requirement for an issuer to obtain consent from the HKMA before issuing any new FRS under its licence.

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[14] *See* https://www.mas.gov.sg/-/media/mas-media-library/publications/consultations/pd/2023/response-to-consultation-on-stablecoins-regulation_15aug2023.pdf, Response to Public Consultation on the Proposed Regulatory Approach for Stablecoin-Related Activities, Page 4.

[15] *See* https://www.japaneselawtranslation.go.jp/en/laws/view/4395, Payment Services Act（Act No. 59 of 2009), Chapter 1, Article 2, Paragraph 5(i). Translated on May 12, 2023.

However, a “new FRS” could also mean an existing FRS issued on a new blockchain, where the “new FRS” is economically equivalent to the existing FRS. In this case, we request that the FRS issuer not be required to obtain consent from the HKMA. This is because introducing the FRS on a new blockchain does not introduce new risks from a value stability perspective, as the FRS will continue to meet the value stability requirements outlined in the Consultation. In this case, we request that a notification to the HKMA should be sufficient.

Such an approach will align with the principle of ‘same risk, same activity, same treatment’, as introducing an FRS on a new blockchain does not introduce new risks.

Question 8: Do you have any view on the proposed arrangements for the offering of FRS?

As outlined in our response to Question 2 above, we believe that FRS for which an issuer does not meet the licensing criteria under Section 6.2(a) of the consultation (such as an issuer of an FRS that derives its value from arbitrage or algorithm) should be considered VAs and be required to meet the requirements under the SFC Guidelines.

This will ensure that the innovation such types of FRS bring to Hong Kong will continue to be supported, and will also allow the HKMA to continue to monitor developments in the stablecoin landscape with a view to bringing other types of stablecoins within the regulatory perimeter when it is needed.

Question 14: Do you have any comments on the proposed transitional arrangement?

Ripple is supportive of the transitional arrangement outlined in Section 13 of the Consultation, in order to allow an appropriate amount of time for industry participants to plan and make changes to ensure compliance and obtain a licence for FRS issuance, where required.

However, Ripple also respectfully requests that in addition to a transition period, an exemption regime also be considered for FRS issuers, and such exemption should be valid till the FRS license application is approved, rejected, or withdrawn.

It would also be beneficial for the list of exempted entities to be made public, to ensure consumers and end-users have a ready reference as to which entities are covered under the exemption regime.

An exemption regime, as outlined above, will ensure minimal disruption to FRS services while license applications are being processed, and will therefore minimise disruptions to consumers and end-users during the transition to a licensing regime.