

March 31, 2022



Hong Kong Monetary Authority
55th Floor
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 Discussion Paper on Crypto-assets and Stablecoins (the "Discussion Paper") published by the Hong Kong Monetary Authority ("HKMA") on January 12, 2022.¹

Ripple would like to thank the HKMA for both the in-depth and comprehensive analysis that has been undertaken in the Discussion Paper and for the opportunity to provide our comments. We respectfully request you take them into consideration as you consider the policy direction and scope of intended regulation for crypto-assets² and stablecoins. We welcome the opportunity for further engagement with the HKMA on this Discussion Paper and any other related consultations as may be appropriate.

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.

¹ 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.

² As noted by the HKMA in section 2.1 of the Discussion Paper, the terms digital asset, virtual currency, cryptocurrency, crypto-asset and others are used interchangeably in the marketplace. For the purposes of this letter, Ripple adopts the terminology and related definitions used by the HKMA in the Discussion Paper.

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 crypto-assets and stablecoins.

Ripple itself applies protocols to drive the efficient globalization of value through multiple initiatives with financial services and open-source communities. RippleNet, our enterprise software solution which is powered by a standardized application programming interface (“API”) and built on the market-leading and open standard Interledger Protocol, enables financial institutions to facilitate faster and less costly cross-border payments. RippleNet 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.

In addition, Ripple offers these entities an On-Demand Liquidity capability which leverages the crypto-asset XRP as a bridge between fiat currencies, further reducing the friction and costs for commercial financial institutions to transact across multiple global markets. XRP is the crypto-asset that is native to the XRP Ledger, a distributed ledger platform.

Although Ripple utilizes XRP and the XRP Ledger in its product offerings, XRP is independent of Ripple. The XRP Ledger is decentralized, open-source, and based on cryptography. Ripple leverages XRP for use in its product suite because of XRP’s suitability for cross-border payments. Key characteristics of XRP include speed, scalability, energy efficiency, and cost.

Protocols used by global, cross-border payment networks and decentralized tools that support them should be considered and supported by the HKMA. 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 as well as fulfil the potential that globalization of value holds.

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.³ 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 crypto-assets like XRP to be seamlessly exchanged to and from “issued assets” including stablecoins. Among the unique features of the DEX is its payment

³ See <https://xrpl.org/issued-currencies-overview.html>, Issued Currencies Overview.

interoperability, which enables payments among those holding and receiving issued assets to minimize costs and work seamlessly when sufficient liquidity is available.

While crypto-assets like XRP and stablecoins can be used to settle payments, 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 will initially focus on developing strategies for cross-border payments and a USD-backed digital currency for Palau.⁴ This could see the implementation of the world's first government-backed national stablecoin. 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.⁵

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

Ripple appreciates the opportunity to provide feedback on the Discussion Paper as the HKMA studies 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 (Policy Director, APAC) at radvani@ripple.com.

Sincerely,

Ripple Labs Inc.

⁴ 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.

⁵ See <https://ripple.com/ripple-press/stasis-to-issue-euro-stablecoin-on-the-xrp-ledger/>, STASIS to Issue Euro Stablecoin on the XRP Ledger.

APPENDIX

Ripple respectfully submits the following responses to the discussion questions set forth in Section 5.3 of the Discussion Paper.

Discussion Question 1:

Should we regulate activities relating to all types of stablecoins or give priority to those payment-related stablecoins that pose higher risks to the monetary and financial systems while providing flexibility in the regime to make adjustments to the scope of stablecoins that may be subject to regulation as needed in the future?

Ripple is supportive of the risk-based approach to regulate stablecoins outlined by HKMA, under which activities related to payment-related stablecoins will be the focus at the initial stage. Ripple is also supportive of HKMA focusing on asset-linked stablecoins linked to a single fiat currency, sometimes referred to as a single currency stablecoin (“SCS”). Finally, we believe flexibility should be built into the regulatory regime, so that adjustments can be made in future if needed.

However, it is worth noting that the HKMA currently does not have any taxonomy to identify payment-related stablecoins, or more broadly, payment-related crypto-assets in general.

Ripple respectfully submits that such crypto-assets should not be solely defined relative to a specific technology (e.g., cryptography), but, for purposes of regulation, should instead fall under a broader heading such as “digital assets,” and subsequently classified depending on the particular economic function and purpose they serve. Such an approach is consistent with that taken by other jurisdictions like the United Kingdom (“UK”) and Singapore, which have issued classifications that do not depend on whether a business model uses distributed ledger technology or not.

For ease of reference, we have summarised the taxonomies for the UK and Singapore respectively in Table 1 & Table 2 below.

Regulated Tokens

a. Security tokens: These are tokens that amount to a 'Specified Investment' under the Regulated Activities Order, excluding e-money. These may provide rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits. They may also be transferable securities or other financial instrument under the EU's Markets in Financial Instruments Directive II. These tokens are likely to be inside the FCA's regulatory perimeter.

b. E-money tokens: These are tokens that meet the definition of e-money under the Electronic Money Regulations. These tokens fall within regulation.

Unregulated Tokens

Any tokens that are not security tokens or e-money tokens are unregulated tokens. This category includes utility tokens which can be redeemed for access to a specific product or service that is typically provided using a blockchain platform.

The category also includes tokens such as Bitcoin, Litecoin and equivalents, and often referred to as 'cryptocurrencies', 'cryptocoins' or 'payment tokens'. These tokens are usually decentralised and designed to be used primarily as a medium of exchange. We sometimes refer to them as exchange tokens and they do not provide the types of rights or access provided by security or utility tokens, but are used as a means of exchange or for investment.

Table 1: Summary of the UK Financial Conduct Authority taxonomy for digital asset

Digital Payment Tokens

Refers to "any digital representation of value that is expressed as a unit; is not denominated in any currency, and is not pegged by its issuer to any currency; is, or is intended to be, a medium of exchange accepted by the public, or a section of the public, as payment for goods or services or for the discharge of a debt; and can be transferred, stored or traded electronically".

Digital tokens which constitute capital markets products

MAS will examine the structure and characteristics of, including the rights attached to, a digital token in determining if the digital token is a type of capital markets products under the Securities and Futures Act. This includes, but is not limited to a share, a debenture, a unit in a business trust, a securities-based derivatives contract, or a unit in a collective investment scheme, as defined under the Securities and Futures Act.

Table 2: Summary of the Monetary Authority of Singapore ("MAS") taxonomy for digital assets

Taking into account the taxonomies of the UK and Singapore discussed above, Ripple respectfully recommends that the HKMA consider adopting a taxonomy consistent with such global practices, thereby providing clarity to the legal character of crypto-assets in Hong Kong.

In line with global practices, we recommend that there be a clear distinction between payment tokens, utility tokens, and security tokens, as outlined below:

- **Payments or Exchange tokens:** to describe non-fiat native digital assets that are used as means of exchange and have no rights that may be enforced against any issuer;

- **Utility tokens:** to describe those digital assets that create access rights for availing service or a network, usually offered through a blockchain platform; and
- **Security tokens:** to describe tokens that create rights mirroring those associated with traditional securities like shares, debentures, security-based derivatives, and collective investment schemes.

It is also worth highlighting that on 7 March, 2022 the MAS clarified the regulatory treatment of stablecoins, including SCS, as digital payment tokens (“DPT”) under the Payment Services Act, 2019.⁶ The MAS will examine the characteristics of the stablecoin to determine the appropriate regulatory treatment, and the MAS also intends to continue to review industry developments relating to stablecoins and assess the appropriate regulatory treatment accordingly.

Ripple respectfully recommends that the HKMA follow a similar approach, and regulate stablecoins as a DPT (or equivalent).

Discussion Question 2:

What types of stablecoin-related activities should fall under the regulatory ambit, e.g. issuance and redemption, custody and administration, reserves management?

Ripple is supportive of the high-level regulatory requirements for stablecoin arrangements identified by HKMA, and the intention to apply these requirements using a risk-based approach. We are also supportive of HKMA continuing to assess the regulation of crypto-assets and stablecoins using the principle of ‘same risk, same activity, same treatment’, adapting rules where necessary to address any regulatory obstacles or challenges specific to crypto-asset development whilst ensuring financial stability and the appropriate regulatory outcomes to support innovation are achieved.

Discussion Question 3:

What kind of authorisation and regulatory requirements would be envisaged for those entities subject to the new licensing regime?

Ripple has no comments on this question.

Discussion Question 4:

What is the intended coverage as to who needs a licence under the intended regulatory regime?

Ripple has no comments on this question.

⁶ See <https://www.mas.gov.sg/-/media/MAS-Media-Library/regulation/faqs/PD/faqs-on-payment-services-act-2019/Payment-Services-Act-FAQ-7-March-2022.pdf>, FAQs on the Payment Services Act, 2019, page 17.

Discussion Question 5:

When will this new, risk-based regime on stablecoins be established, and would there be regulatory overlap with other financial regulatory regimes in Hong Kong, including but not limited to the SFC's VASP regime, and the SVF licensing regime of the PSSVFO?

Ripple is supportive of the way forward proposed by HKMA, namely to ensure that any risks that may be posed by stablecoins are appropriately addressed through a risk-based regulatory framework. Ripple is also supportive of HKMA coordinating with other stakeholders in developing the regulatory regime for stablecoins, and we welcome further engagement on this front.

Discussion Question 6:

Stablecoins could be subject to run and become potential substitutes of bank deposits. Should the HKMA require stablecoin issuers to be AIs under the Banking Ordinance, similar to the recommendations in the Report on Stablecoins issued by the US President's Working Group on Financial Markets?

Ripple believes that at present, stablecoins are not widely used in the Hong Kong economy as a means to purchase goods and services and hence present no systemic payment risks, and therefore stablecoin issuers should not be required to be Authorised Institutions ("AIs") under the Banking Ordinance.⁷ We would also like to reiterate the need for a taxonomy for crypto-assets outlined in our response to Discussion Question 1 above, to clearly identify payment crypto-assets which we believe will also make it easier to identify systemically important payment crypto-assets.

At the same time, we appreciate that a global stablecoin could potentially have a significantly large user base, and widespread adoption of such a global stablecoin token could fulfill the definition of systemic.

However, it is important to note that what is 'systemic' is subjective, and no definition of what would be considered to be systemic is provided in the Discussion Paper. Therefore, we respectfully request that HKMA develop clear considerations for determining systemic stablecoin issuers, aligned with the considerations identified by the Committee on Payments and Market Infrastructures and Board of the International Organization of Securities Commissions (collectively "CPMI-IOSCO"),⁸ prior to requiring stablecoin issuers to be AIs under the Banking Ordinance.

In keeping with the principle of 'same risk, same activity, same treatment', Ripple believes a systemically important stablecoin arrangement could appropriately be assessed to be an AI, in the same way that Retail Payment Systems ("RPSs") are designated under the

⁷ See <https://www.elegislation.gov.hk/hk/cap155>, Cap. 155 Banking Ordinance.

⁸ See <https://www.bis.org/cpmi/publ/d198.pdf>, Consultative report on the application of the Principles for Financial Market Infrastructures to stablecoin arrangements.

Payment Systems and Stored Value Facilities Ordinance (“PSSVFO”).⁹ However, the designation of an RPS is subject to a number of criteria being met¹⁰ (for example, when potential disruption could lead to financial stability risks), and hence we respectfully request that HKMA clearly define the metrics and criteria by which a stablecoin arrangement will be measured against when determining if it is systemic.

Discussion Question 7:

Would the HKMA also have plan to regulate unbacked crypto-assets given their growing linkage with the mainstream financial system and risk to financial stability?

Ripple understands that the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022 (“AMLO Amendment Bill”)¹¹ is expected to be introduced in the Legislative Council in the second quarter of 2022, which proposes to introduce a licensing regime for virtual asset service providers (“VASPs”). The HKMA and Securities and Futures Commission also published a joint circular on intermediaries’ virtual asset-related activities on 28 January, 2022,¹² and the HKMA published a separate circular on AIs activities relating to virtual assets and VASPs on the same day.¹³

While a licensing regime and guidance on crypto-assets would be welcome, Ripple respectfully reiterates its suggestion regarding the need to establish a crypto-asset taxonomy, as outlined in our response to Discussion Question 1 above, in order to complement any licensing and regulatory regime being implemented as well as provide clarity to the legal character of crypto-assets in Hong Kong.

Discussion Question 8:

For current or prospective parties and entities in the stablecoins ecosystem, what should they do before the HKMA’s regulatory regime is introduced?

Ripple appreciates the opportunity to provide feedback on the Discussion Paper as the HKMA studies these important issues, and we would encourage and support further dialogue with all stakeholders before the HKMA’s regulatory regime is introduced.

⁹ See <https://www.elegislation.gov.hk/hk/cap584>, Cap. 584 Payment Systems and Stored Value Facilities Ordinance

¹⁰ See https://www.hkma.gov.hk/media/eng/doc/key-functions/financial-infrastructure/Explanatory_note_on_RPS_designation.pdf, Explanatory Note on Designation of Retail Payment Systems, page 7.

¹¹ See <https://www.legco.gov.hk/yr2022/english/panels/fa/papers/fa20220207cb1-32-2-e.pdf>, Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022.

¹² See <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2022/20220128e2.pdf>, joint circular on intermediaries’ virtual asset-related activities.

¹³ See <https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2022/20220128e3.pdf>, Regulatory approaches to Authorized Institutions’ interface with Virtual Assets and Virtual Asset Service Providers.