

market notes: Hong Kong's Pathway to Prudence

The headlines read “Hong Kong is crypto-friendly.” We had to evaluate it first-hand. Optimism is everywhere and forward-thinking is the norm. But it's measured – a prudent path. And that's good.

14 July 2023

Marcel Kasumovich

Coinbase Asset Management

The headlines read “Hong Kong is crypto-friendly.” We had to evaluate it first-hand. Optimism is everywhere and forward-thinking is the norm. But it’s measured – a prudent path. And that’s good.

market notes: Hong Kong’s Pathway to Prudence
7/14/23- Marcel Kasumovich, Deputy CIO, Coinbase Asset Management

1. Hong Kong International Airport (HKIA) Metaverse. The banner can’t be missed, spanning multiple shops on the first step arriving at HKIA this week. A code to scan takes you directly to a Web3 experience (Figure 1). It’s a pilot on the gamification of travel where players can win limited edition NFTs. It’s crypto asset adoption through the backdoor. Inside you will find JCDecaux well-branded. This, too, is telling – JCDecaux revolutionized outdoor advertising, and see Web3 as an opportunity to ply their craft.
2. So, we played, and studied. The main graphic style is a “vox,” like the world’s best-selling game Minecraft. A “voxel” is the smallest area of virtual blockchain worlds, or “the Metaverse.” The [HKIA Metaverse](#) is coordinated through [Voxels Metaverse](#), the oldest virtual world run on Ethereum. Like so many players in the crypto asset ecosystem, it’s built on centralized onramps. But assets are owned by the player and [analytic tools](#) are being developed to value them. That’s the branding opportunity.
3. What about the rules for crypto entering the mainstream? Even the escalators serving outstanding Hong Kong trains have rules – hold the rail, stand firm, and don’t walk. Of course, nobody holds the rail and most walk. Rules are fragile, many feel they are built to be broken, and forced to adjust with progress. Regulatory friction in the metaverse is limited. It’s a game. The stakes are low. When the value of player assets builds and trades, rules will find them! In the meantime, it’s a terrific sandbox for crypto assets.
4. A simple metaverse experience also shows what’s missing – a killer wallet application. A killer app like the Octopus Card, a staple in Hong Kong. What started as a smartcard for public transit is now used at stores and restaurants. Several cities adopted the architecture. The penetration rate is 98% for HK residents between the ages of 15 and 64. It ends up being an efficient way of paying for small ticket items. Yet, to buy or load the card requires cash! Digital wallets are the next generation of such cards.
5. But on all things tied to money, regulatory bodies are far more alert. The Octopus Card was only able to expand its potential after the Hong Kong Monetary Authority (HKMA) granted it a license as a deposit-taking company. That was thirteen years after its initial launch – a good benchmark for appreciating entry into the regulatory mainstream. Yes, the Metaverse greeting when landing in Hong Kong fits a crypto-friendly pivot. But our meetings demonstrated this as more of a continuum than a pivot.
6. Take the HKMA guideline. The monetary authority published its [consultation paper](#) on crypto assets on January 12, 2022, with particular attention to payment-based stablecoin. The commitment to regulatory clarity was in motion long before that paper. Feedback was broad, all collected in the first quarter of last year. The [conclusions](#) were finalized a year later. A year of

severe stress for crypto markets almost surely slowed the path but it did not prevent clear conclusions – a prudent pathway.

7. The HKMA focus is on money – stablecoin, where they now have regulatory authority. Entities that conduct activity in Hong Kong will require a license. No exceptions. Activity must also be narrow; stablecoin issuers cannot engage in borrow-lending. A stablecoin’s value must be redeemable into the referenced fiat currency “at par, within a reasonable period.” Algorithmic and arbitrage stablecoin are out. Governance, issuance, reserves, and wallets are key areas under HKMA watchful eyes.
8. It’s a clear message – measured growth. Regulations will be clear...and tight. The Hong Kong Securities and Futures Commission (SFC) is attentive to consumer protections. The standards for virtual asset trading on retail platforms are much greater than institutional investors, where platforms must ensure they are catering to professional investors. This is also evident even in stablecoin, where the SFC judges it inappropriate for retail investors. Regulatory clarity is not a “wild west” moment, it’s tight, prudent rules.
9. But it’s not timid. Experiments are ongoing. The BIS Innovation Hub in Hong Kong is using mBridge as a tool for testing multi-currency international rails between the Hong Kong Monetary Authority, the Bank of Thailand, the People’s Bank of China, and the Central Bank of the United Arab Emirates. Real transactions were run through commercial banks. It went well enough to encourage a second round of trials, but with enough hiccups that the HKMA stays open to the private sector leading the innovation.
10. Where is consensus emerging? Ethereum rails are being forked into “private” chains mostly to include governance parameters set by regulatory bodies. The fingerprints of crypto innovators are everywhere. The permissioned layer is being expanded using zero-knowledge proofs for privacy – a central bank sees everything; a commercial bank can only see their transactions. Tools are even being used from abandoned projects. HotStuff+, a key component to Libra, is integrated into mBridge.
11. Our main lesson – Hong Kong’s path is subtle. The regulatory environment is clear. And tight. Growth is likely to center on crypto bridging real, relatable experiences. Tokenization is a natural avenue for an efficiency gain to property rights, more than a hunt for immediate liquidity. It is quieter adoption led by incumbents working alongside experts. mBridge doesn’t emphasize its use of Ethereum. Google Play is quiet about the integration of digital assets into its wallets this week.
12. Hong Kong is a terrific benchmark for crypto asset adoption. It’s measured. But it’s happening. It’s a cycle of regulatory compliance and conservatism. We greatly appreciate the hospitality of friends and colleagues.

Figure 1: HKIA Metaverse – Brands Everywhere!



Source: <https://www.voxels.com/play?coords=S@474E,621N>

Disclaimer:

This communication, including any attachments, is intended only for the use of the addressee and may contain information that is confidential or otherwise protected from disclosure. Any unauthorized use, distribution, modification, forwarding, copying or disclosure is strictly prohibited. If you have received this communication in error, please delete this message, including any attachments, and notify the sender immediately. The information and any disclosures provided herein do not constitute a solicitation or offer to purchase any security or other financial product or investment and is not intended as investment, tax, or legal advice. Unless otherwise noted, all information is estimated, unaudited and may be subject to revision without notice. Past results are not indicative of future results.

information is estimated, unaudited and may be subject to revision without notice. Past results are not indicative of future results.

This communication may contain statements of opinion, including but not limited to, the author's analysis and views with respect to: digital assets, projected inflation, macroeconomic policy, and the market in general. Statements of opinion herein have been formulated using the author's experience, research, and/or analysis, however, such statements also contain elements of subjectivity and are often subjective in nature. In addition, when conducting the analyses on which it bases statements of opinion, the author(s) will incorporate assumptions, which in some cases may be shown to be inaccurate in the future, including in certain material respects. Nothing in this presentation represents a guarantee of any future outcome. The author(s) are under no obligation to update this document, notify any recipients, or re-publish the content contained herein in the event that any factual assertions, assumptions, forward-looking statements, or opinions are subsequently shown to be inaccurate.

Certain information contained in this Communication constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may", "will", "should", "expect", "anticipate", "target", "project", "estimate", "intend", "continue" or "believe" or the negatives thereof or other variations thereon or comparable terminology. Forward-looking statements made in this communication are based on current expectations, speak only as of the date of this communication, as the case may be, and are susceptible to a number of risks, uncertainties and other factors. Assumptions relating to the foregoing involve judgments with respect to, among other things, projected inflation, the regulation of digital assets and macroeconomic policy, all of which are difficult or impossible to predict accurately and many of which are beyond our control. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation to future results or that the objectives and plans expressed or implied by such forward-looking statements will be achieved.

Certain information contained herein may have been obtained from third party sources and such information has not been independently verified by the author(s). References herein to third parties are for illustrative purposes and are not an endorsement or recommendation for products or services. No representation, warranty, or undertaking, expressed or implied, is given to the accuracy or completeness of such information. While such sources are believed to be reliable, the author(s) do not assume any responsibility for the accuracy or completeness of such information.

The information and any disclosures provided herein do not constitute a solicitation or offer to purchase any security or other financial product or investment and is not intended as investment, tax, or legal advice. Unless otherwise noted, all