

RE: HKMA'S LAUNCH OF DIGITAL BOND GRANT SCHEME

On 28 November 2024, the Hong Kong Monetary Authority (the “HKMA”) launched the Digital Bond Grant Scheme (the “DBGS”), offering grants of up to **HK\$2.5 million** to reimburse certain expenses incurred in relation to eligible digital bond issuances in Hong Kong, with details set out in the Guideline on the Digital Bond Grant Scheme issued by the HKMA on the same date (the “Guideline”).

Initially announced by the Hong Kong government in the 2024 Policy Address, the DBGS aims to promote the development of the digital securities market, in particular tokenised bonds, and encourage broader adoption of tokenisation technology in capital market transactions.

In this Client Alert, we provide an overview of the key requirements and features of the DBGS and share our observations on the subject.

A. Overview of the DBGS

(a) Eligibility for Grant

The DBGS offers a two-tiered grant scheme for digital bonds¹ issued in Hong Kong on or after 16 October 2024, with eligibility requirements summarised in the following table:

	Tier 1 – Half Grant	Tier 2 – Full Grant
Grant Amount	Up to HK\$1.25 million	Up to HK\$2.5 million
Eligibility Requirements	<p>To qualify for the Half Grant, a digital bond must meet the following requirements (collectively, the “Basic Requirements”):</p> <p>(1) <u>Issued in Hong Kong</u>: the digital bond must be issued in Hong Kong, i.e. at least half of the involved lead arranger(s) must be arranger(s) with substantial Hong Kong debt capital market operations as recognised by the HKMA; and</p> <p>(2) <u>Digital Team / DLT platform</u>:</p> <p>(a) the team involved in the development and/or operations of the DLT platform and other digital aspects of the issuance (the “Digital Team”)² has a substantial</p>	<p>To qualify for the Full Grant, a digital bond must meet the following requirements in addition to the Basic Requirements:</p> <p>(1) <u>DLT platform</u>: be Issued on a DLT platform which is provided by an entity which is <u>not</u> an associate⁵ of the issuer;</p> <p>(2) <u>Minimum issue size</u>: be Issued at a minimum size of HK\$1 billion or equivalent (including all tranches, if applicable);</p> <p>(3) <u>Initial investors</u>: be issued initially to at least five (5) investors that are <u>not</u> associates of the issuer or the DLT platform provider(s); and</p> <p>(4) <u>Listing</u>: be listed on the Stock</p>

¹ As defined in the Guideline, “digital bond” generally refers to a bond that utilises distributed ledger technology (“DLT”) for digital representation of ownership (including, for example, legal titles and/or beneficial interests in the bond).

² The Digital Team may include, without limitation, roles in project or business management, information technology, engineering, operations, legal and compliance, issuer services and securities services.

⁵ According to the Guideline, for the purpose of the DBGS, an “associate” of the issuer refers to: (i) a person or corporation over which the issuer has control; (ii) a person or corporation which has control over the issuer; or (iii) a person or corporation that is under the control of the same person or corporation as the issuer, excluding persons or corporations which are associated merely because of common ownership by the central government of a country or its sovereign wealth funds or similar state-owned enterprises but which in practice operate independently as separate commercial entities.

	Hong Kong presence; ³ or (b) the bond is issued on a DLT platform operated by the Central Moneymarkets Unit (the "CMU"). ⁴	Exchange of Hong Kong Limited (the "SEHK") or one or more virtual asset trading platform(s) ("VATP(s)") licensed by the Securities and Futures Commission (the "SFC").
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An issuer (including its associates) may receive subsidies under the DBGs for a maximum of **two (2)** digital bond issuances.

(b) Eligible Expenses

Subject to the relevant maximum grant size, the DBGs covers **fifty percent (50%)** of the eligible expenses incurred by the issuer for each digital bond issuance, including the following:

- (i) Fees to DLT platform providers (other than associates of the issuer);
- (ii) Fees to arrangers based in Hong Kong (other than associates of the issuer);
- (iii) Fees to legal advisors based in Hong Kong;
- (iv) Fees to auditors, accountants and rating agencies based in Hong Kong;
- (v) Listing fees to the SEHK or VATPs licensed by the SFC; and
- (vi) CMU lodging and clearing fees.

Notably, expenses which are covered by other grant scheme(s) within or outside Hong Kong will not be eligible for reimbursement under the DBGs.

(c) Timeline and Application Procedures

The DBGs is effective for an initial period of three (3) years commencing from 28 November 2024. Application for grant under the DBGs may be made within three (3) months after the issuance of the digital bond by the issuer, the lead arranger(s) and/or the DLT platform provider(s).

Potential applicants may also request a pre-application consultation with the HKMA. A no-objection will be given by the HKMA if it is satisfied, on the basis of the preliminary information provided, that the digital bond issuance meets the relevant eligibility requirements of the DBGs.

B. Our Observations

In recent years, Hong Kong has seen rapid development in the realm of digital securities, with a number of successful digital bond issuances in the last two (2) years, most notably the Hong Kong government's pioneering tokenised green bonds⁶ as well as the digital bonds issued by The Hong Kong and Shanghai Banking Corporation Limited ("HSBC")⁷ and GF Securities (Hong Kong) Brokerage Limited ("GF Securities HK") in the private sector.⁸

³ The HKMA will take into account factors such as size and composition (including seniority) of the team based in Hong Kong.

⁴ The CMU is a central securities depository for debt securities owned and operated by the HKMA.

⁶ The Hong Kong government has carried out two (2) tokenised green bond issuances under the Government Green Bond Programme, with an offering of HK\$800 million in February 2023 and approximately HK\$6 billion in February 2024.

⁷ In September 2024, the HSBC issued digital notes at a total issue size of HK\$1 billion and tenor of one (1) year, which have been listed on the SEHK (Stock Code: 5226).

⁸ In January 2024, GF Securities HK, a subsidiary of GF Securities Co., Ltd. (SEHK Stock Code: 1776), issued tokenised bonds on the Ethereum blockchain in the total amount of US\$100 million.

The launch of the DBGS followed the SFC's circulars dated November 2023 (the "**Circulars**"),⁹ in which the SFC provided regulatory guidance in relation to the offer and distribution of digital securities, distinguishing between: (i) digital securities which are or represent traditional financial instruments (the "**Tokenised Securities**"), such as tokenised bonds and tokenised funds; and (ii) digital securities which are or represent non-conventional securities (the "**Non-Conventional Digital Securities**"), such as collective investment schemes¹⁰ involving the tokenisation of fractionalised interests in real world assets ("**RWA**"). Due to the relative complexity and associated risks of Non-Conventional Digital Securities, the SFC expressed greater readiness (subject to compliance with the applicable requirements) to consider and approve the offering and distribution of Tokenised Securities in the initial stage,¹¹ and it is therefore not surprising that the coverage of the DBGS is very limited and currently only covers the issuance of digital bond, a subset of Tokenised Securities.

Nevertheless, the DBGS comes as a welcome initiative by the Hong Kong government to boost the development of the digital securities market and the virtual asset economy in Hong Kong. In particular, given the relatively lower bar to qualify for the Half Grant without stipulations as to issue size, investor base and listing, the introduction of the DBGS is likely to lessen the costs of digital bond issuance in Hong Kong and thereby encourage home-grown enterprises or even start-ups to participate in the emerging digital securities market, which has so far been dominated by larger institutions.

Furthermore, the recent grant of licences by the SFC to four (4) additional VATPs (which had been deemed to be licensed since 1 June 2024 subject to restrictions in their business operations and marketing) on 18 December 2024,¹² with more VATP licences expected to be granted the first quarter of 2025, will provide digital bond issuers with a greater number of available options in terms of potential listing venues in a more diversified market.

However, certain questions remain as to eligibility and coverage of the DBGS. For instance, it is unclear whether the engagement of Hong Kong-based arrangers (which are often not involved in smaller issues in which the bonds are issued directly to investors sourced through the issuer's own avenues without the participation of intermediaries) is necessary for the digital bond to be regarded as being issued in Hong Kong or whether it would be sufficient for the issuer, the DLT platform provider and/or listing platform to be based in Hong Kong.

In addition, whilst on the face of it the Guideline does not impose restrictions as to the underlying structures of the digital bonds which would be eligible for the DBGS, it remains to be seen whether digital bonds with relatively more complex or hybrid structures (such as convertible bonds and exchangeable bonds) would be permitted to obtain the grant under the DBGS, particularly in view of the current position of the SFC as expressed in the Circulars. Meanwhile, market participants are also anticipating the introduction of similar grant schemes for other categories of investment products (including tokenised funds and other tokenised investment products) to support the well-rounded development of the Hong Kong digital securities market.

⁹ "Circular on tokenisation of SFC-authorised investment products" and "Circular on intermediaries' tokenised securities-related activities".

¹⁰ As defined in Part 1 of Schedule 1 to the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong).

¹¹ For details on the Circulars, please refer to our Client Alert dated 12 December 2023.

¹² As of the date of this Client Alert, seven (7) VATPs have been licensed by the SFC under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Chapter 615 of the Laws of Hong Kong) (the "AMLO"), including: (i) OSL Exchange operated by OSL Digital Securities Limited; (ii) HashKey Exchange operated by Hash Blockchain Limited; (iii) HKVAX operated by Hong Kong Virtual Asset Exchange Limited; (iv) HKbitEX operated by Hong Kong Digital Asset EX Limited; (v) Accumulus operated by Accumulus GBA Technology (Hongkong) Co., Limited; (vi) DFX Labs operated by DFX Labs Company Limited; and (vii) EX.IO operated by Thousand Whales Technology (BVI) Limited.

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We have advised our clients on a variety of RWA projects and are also currently involved in providing consultation and other legal services in relation to tokenised securities as well as application for the DBGS. If you have any views or questions in relation to this Client Alert or the DBGS or are interested in issuing digital bonds, please do not hesitate to get in touch with our team members at ly@lylawoffice.com or at (+852) 2115-9525.

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