

The Transformation of the Global Trade and Financial System

From Enduring Principles to International Standards, Hong Kong's Regulatory Architecture, and Strategic Positioning for the New Financial Order

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Module I

The Philosophical Foundations of
Financial Regulation

Module II

The Transformation of Global Trade &
Financial Architecture

Module III

Hong Kong's Regulatory Architecture

Module IV

Hong Kong's Strategic Positioning

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| A Strategic Journey in Four Modules

01 The Foundation: Enduring Ideas & Standards

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 - Evolution of Basel (I to IV)
 - Systemic Risk & Macro-prudential Policy
-

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- The “Super-Connector” 2.0 Model
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The Philosophical Foundations of Financial Regulation

Why Regulate? What Endures? How Principles Became International Standards.

Key Questions This Module Answers

What market failures justify financial regulation?

What are the seven enduring ideas that recur across banking, securities, and insurance?

How did the Basel Committee, IOSCO, and IAIS encode these ideas into global standards?

What does the digital transformation challenge — and what does it leave intact?

Why Regulate Finance? The Five Market Failures

Financial regulation is not a political preference — it is a response to structural features of finance that markets cannot self-correct.

Market Failure	Mechanism	Regulatory Response
Information Asymmetry	Depositors cannot assess bank quality; investors cannot verify issuer claims.	Mandatory disclosure; licensing standards; fit-and-proper requirements.
Moral Hazard	Deposit insurance and "too big to fail" insulate institutions from full risk consequences.	Capital requirements; resolution regimes; bail-in mechanisms.
Negative Externalities	A bank's failure imposes costs on the entire economy far beyond shareholder losses.	Macroprudential tools; SIFI surcharges; activity restrictions.
Maturity Transformation	Banks borrow short, lend long — even solvent banks can fail in a run.	LCR; NSFR; lender-of-last-resort facilities.
Procyclicality	Financial institutions amplify booms and busts through correlated behaviour.	Countercyclical capital buffers; through-the-cycle provisioning.

"Financial regulation is justified by market failure theory — the identification of conditions under which unregulated markets produce socially suboptimal outcomes."

The Three Regulatory Objectives

| IOSCO's 1998 Formulation Remains the Universal Regulatory Constitution

01

Protecting Investors

Depositors, policyholders, and investors cannot independently assess the quality or solvency of the institutions they entrust with their assets.

Addresses Market Failures:
Information Asymmetry & Moral Hazard

02

Ensuring Fair, Efficient & Transparent Markets

Market integrity is a public good. Its absence imposes costs on all participants through fraud, manipulation, and loss of confidence.

Addresses Market Failures:
Negative Externalities & Information Problems

03

Reducing Systemic Risk

Individual institutions do not internalise the full social cost of their risk-taking. Failure of one can trigger cascading collapse.

Addresses Market Failures:
Negative Externalities & Procyclicality

*“These three objectives are **not sector-specific**. They apply equally to banking (Basel), securities (IOSCO), and insurance (IAIS) — the specific implementations differ; the intellectual logic is identical.”*

The Basel Committee: From Concordat to Capital

The Committee Was Born from Supervisory Gaps, Not Capital Deficiency

1974

Genesis: The Herstatt Risk

The collapse of **Bankhaus Herstatt** (Germany) and **Franklin National Bank** (US).

- Casualties of unhedged FX positions
- Exposed the complete absence of cross-border supervisory coordination

1975

The Concordat

Established the foundational principle:
no bank should escape supervision

- Divided responsibility between home and host supervisors
- Remains Basel Core Principle 1 today

1988

Basel I: The Capital Revolution

Triggered by the Latin American debt crisis.

- **8% minimum capital ratio applied To risk weighted assets**
- Five broad risk weight categories (0% for OECD gov bonds → 100% for corporate loans)

The Genius and the Flaw

Simplicity created a universal metric but also enabled **regulatory arbitrage** — banks shifted into higher-yielding instruments with lower risk weights, maintaining regulatory compliance while increasing actual risk.

Basel II: The Three-Pillar Architecture (2004)

The Framework That Still Governs Global Banking

“If creditors know they will bear losses (resolution regimes) and have information to assess risk (Pillar 3), market discipline becomes a regulatory tool.”

01

Minimum Capital Requirements

Expanded from credit risk only to include **market** and **operational risk**.

Introduced the **Internal Ratings-Based (IRB)** approach, allowing sophisticated banks to use their own models to calculate capital needs.

Premise: Internal models are superior to standardised formulas.

02

Supervisory Review Process

Required banks to hold capital commensurate with their **overall risk profile**, not just Pillar 1 risks.

Captures concentration risk, interest rate risk in the banking book, and reputational risk.

Goal: Ensure capital adequacy beyond simple ratios.

03

Market Discipline

Disclosure requirements enabling counterparties and investors to assess risk.

The intellectual insight: Regulation cannot substitute for market discipline — it must complement it by ensuring information flows.

Mechanism: Informed investors discipline management through pricing.

The Global Financial Crisis: Basel II's Fatal Flaw

The 2008 Crisis Exposed That Measuring Individual Risk Is Not the Same as Managing Systemic Risk

Systemic Risk Ignored

Measured individual bank risk but ignored the emergent property of the system.

Tail Risk Understated

Internal models systematically underestimated extreme events (e.g. subprime mortgage defaults).

Loose Capital Definitions

Hybrid instruments counted as capital but proved non-loss-absorbing during the crisis.

Liquidity Unmeasured

Banks were capital-adequate but liquidity-insolvent; maturity transformation was ignored.

Procyclicality Baked In

Mark-to-market accounting and risk models amplified the boom-bust cycle.

The Conceptual Advance

“Systemic risk is an emergent property of the system, not a characteristic of individual institutions. A financial system composed entirely of individually sound banks can collectively be fragile.”

Goodhart & Persaud
The Fundamental Principles of Financial
Regulation (2008)

Basel III: The Macroprudential Turn (2010–2019)

Five Conceptual Advances That Redefined Prudential Regulation

Reform	Mechanism	Enduring Idea
Capital Quality (CET1)	Common equity as the only true loss-absorber; hybrid instruments phased out.	<i>Capital must absorb losses before insolvency, not merely in liquidation.</i>
Capital Conservation Buffer	Additional 2.5% above minimum; automatic dividend/bonus restrictions when breached.	<i>Automatic restraint without discretionary supervisory intervention.</i>
Countercyclical Capital Buffer (CCyB)	0–2.5% built during credit booms, deployable in busts.	<i>First explicit anti-procyclicality mechanism — addresses the collective action problem.</i>
Liquidity Standards (LCR & NSFR)	30-day stress survival (LCR); one-year stable funding (NSFR).	<i>Addresses the maturity transformation vulnerability Basel I and II ignored.</i>
Leverage Ratio	3% non-risk-weighted backstop.	<i>Prevents excessive leverage even when models say assets are “safe”.</i>

“The leverage ratio embodies a profound philosophical admission: complex risk models are themselves vulnerable to manipulation. A simple backstop is necessary.”

Basel IV: From Trust in Models to Scepticism

The Output Floor Represents a Fundamental Philosophical Reversal

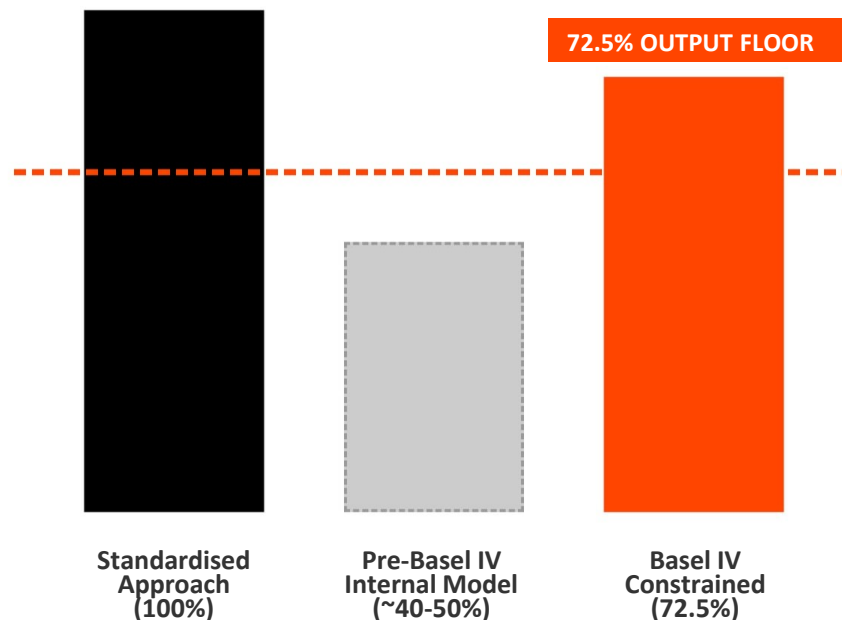
The Internal Models Problem

Banks using Internal Ratings-Based (IRB) approaches systematically produced lower risk weights than standardised approaches — without evidence of better risk management. The gap reflected **model gaming**.

The Output Floor Solution

Internally modelled capital requirements cannot fall below **72.5%** of the standardised approach (implementing 2025–2028).

“Internal models can inform risk management, but regulatory capital must be anchored to a standardised floor to prevent gaming.”



Also Note: Basel Core Principles (2024 Revision) —
The primary global supervisory benchmark.

IOSCO: The Intellectual Architecture

| The 38 Principles Encode the Disclosure Paradigm as the Foundation of Investor Protection

The Disclosure Paradigm

“Sunlight is the best disinfectant.”

— Louis Brandeis, 1914

The premise: Regulators cannot be omniscient, but they can mandate that those who know (issuers) reveal what they know to those who rely on them (investors). Informed investors then discipline management through market pricing.

Regulator (1–5)

Independence, accountability, transparent processes

Enforcement (8–10)

Inspection, investigation, cross-border cooperation

Issuers (14–16)

Full, accurate, timely disclosure of material information

Intermediaries (21–24)

Capital requirements, conduct standards, client money segregation

Secondary Markets (25–30)

Fair price formation, market abuse prevention, clearing

Systemic Risk (31–32)

Post-GFC addition — macroprudential evolution

Benchmarks (33–38)

Post-LIBOR addition — manipulation as systemic fraud

The IAIS: Insurance Regulation's Distinctive Logic

Insurance Regulation Addresses a Structurally Different Market Failure from Banking

Banking Model

Liability (deposit) is liquid; Asset (loan) is illiquid.

Primary Risk: Liquidity

Insurance Model

Premium received before liability (claims) is known.

Primary Risk: Reserving Adequacy

The Long-Tail Problem: Insolvency may not be apparent for decades. Policyholders cannot assess solvency until it is too late.

Key IAIS Insurance Core Principles

ICP 5 Suitability of Persons

Institutional soundness begins with individual integrity and competence. Fit-and-proper requirements are the first line of defense.

ICP 17 Capital Adequacy

Graduated intervention: PCR (intensified supervision) → MCR (authorisation withdrawn). Capital acts as the final buffer.

ICP 14 Valuation

Reserves must be sufficient to meet obligations with a prudent margin. Valuation is the bedrock of insurance solvency.

ICP 23 Group-wide Supervision

Legal entity boundaries do not contain risk — the lesson of AIG. Supervisors must look across the entire group structure.

The FSB: Systemic Risk as an Emergent Property

| The Single Most Important Conceptual Advance of Post-2008 Regulation

The Conceptual Advance

“Systemic risk is an emergent property of the system — not a characteristic of individual institutions.”

From Microprudential

“Is each firm sound?”



To Macroprudential

“Is the system sound?”

G-SIFIs **Capital Surcharges**

Additional capital buffers for institutions whose distress would cause global disruption — internalising the negative externality.

TLAC **Resolution**

Total Loss-Absorbing Capacity ensures shareholders and creditors, not taxpayers, bear losses in resolution (Bail-in vs Bail-out).

OTC Derivatives **Transparency**

Mandatory central clearing, trade reporting, and margin requirements to address the opacity that made AIG's collapse systemically threatening.

Peer Review **Accountability**

Mechanism for accountability without formal enforcement — reputational pressure creates compliance incentives among sovereigns.

Origin: Created by the G20 in April 2009 as the Apex Coordinator of Standard-Setters

The Seven Enduring Ideas: A Synthesis

Seven Propositions That Have Survived Every Crisis, Every Innovation, Every Jurisdiction

Enduring Idea	Core Proposition	Why It Persists
01 Capital as Loss-Absorbing Buffer	Risk-calibrated capital protects depositors/policyholders before insolvency.	<i>Aligns shareholders' interests with prudent risk-taking.</i>
02 The Disclosure Imperative	Those who know must reveal what they know to those who rely on them.	<i>Harnesses market discipline — more powerful than any supervisor.</i>
03 Conduct Standards & Duty of Care	Regulated entities owe a duty of care to clients whose trust they solicit.	<i>Corrects the information asymmetry and power imbalance.</i>
04 Institutional Independence	Regulatory effectiveness requires freedom from political interference.	<i>Without independence, regulators face irresistible pressure to forbear.</i>
05 Systemic Risk as Collective Action	No individual institution internalises the costs its failure imposes on others.	<i>Systemic risk is the purest market failure — privately optimal, socially catastrophic.</i>
06 Moral Hazard & Safety Nets	Every safety net creates incentives for excessive risk-taking.	<i>The tension between safety nets and moral hazard is permanent.</i>
07 Cross-Border Coordination	Capital is mobile; regulation is territorial.	<i>Financial globalisation is irreversible; arbitrage undermines national rules.</i>

Where Enduring Ideas Meet New Challenges

| The Digital Transformation Challenges Institutional Implementations, Not the Principles Themselves

Enduring Principle	Traditional Implementation	Digital Translation Challenge
Capital Adequacy	Minimum capital ratios for licensed banks (legal entities).	How to apply to DeFi protocols with no legal entity?
Disclosure	Issuer prospectus and periodic reporting.	How to mandate disclosure when tokens are algorithmically minted?
Conduct Standards	Suitability and best execution rules for brokers.	How to regulate algorithmic market makers with no human discretion?
Institutional Independence	Supervisor insulated from political pressure.	Who supervises code governance — and are they independent?
Systemic Risk Monitoring	Supervisory data collection and stress testing.	How to monitor real-time on-chain composability and contagion?
Cross-Border Coordination	MMoUs and information sharing between jurisdictions.	How to coordinate when blockchains have no jurisdiction?

“The regulatory challenge is not abandoning these principles but translating them from supervising institutions to supervising infrastructure.”

From Post-War Expansion to Digital Fragmentation

Seven Decades of Growth, a Structural Slowdown, and the Rewiring of the Financial System

Key Questions This Module Answers

What drove seven decades of unprecedented trade expansion?

Why has trade growth collapsed from 6–7% to barely 1–2% annually?

How is US-China decoupling reshaping global trade and capital flows?

How is digitalization rewiring the financial architecture from within?

What are the regulatory implications of these structural changes?

Seven Decades of Trade Expansion: Three Waves

Post-War Trade Expansion Was Driven by Institutions, Technology, and China's Integration

Wave 1

1948–1973

7–8%

Avg. Annual Growth

Reconstruction & Institutions

Bretton Woods institutions, GATT's MFN principle, Western post-war reconstruction.

Wave 2

1973–1995

5–6%

Avg. Annual Growth

Technology & Services

Containerisation, aviation, telecom revolution, and the rise of emerging markets.

Wave 3

1995–2008

6–7%

Avg. Annual Growth

Hyper-Globalisation

WTO establishment, China's 2001 accession, and the Global Value Chain (GVC) revolution.

The Structural Slowdown

2012–2019

2.5%

Post-GFC Investment Slump

2025–2026

1.8%

Fragmentation & Tariffs

"Real global exports in 1997 were approximately 14 times their 1950 level."

The Structural Slowdown: Four Causes

The Post-War Trade Boom Has Ended — Four Structural Forces Explain the Collapse

01

Weakening Investment

Trade is disproportionately driven by investment goods and intermediate inputs. Post-GFC investment weakness reduced annual real import growth by approximately **1.75 percentage points**.

02

The GVC Growth Plateau

Global Value Chains cannot expand indefinitely. The “low-hanging fruit” of offshoring has been picked. OECD data shows cumulative trade costs **stabilised after 2011**.

03

Rising Protectionism

US tariffs on Chinese goods rose from ~11% to nearly **35% by 2025**. “Friend-shoring” and industrial policy subsidies are accelerating fragmentation.

04

Stalled Liberalisation

The Doha Round failed. The WTO's dispute settlement mechanism has been weakened by the blocking of Appellate Body appointments. The institutional engine has stalled.

US-China Decoupling: The Empirical Picture

| A Structural Break in the World's Most Important Commercial Relationship

The Unwinding

21.6% → 13.9%

China's Share of US Imports (2017–2023)

The combination of Section 301 tariffs and “de-risking” policies has successfully reduced direct reliance, though trans-shipment via third countries masks the full picture.

2023 Milestone

Mexico surpassed China to become the United States' largest trading partner for the first time in two decades.

The Strategic Pivot

> G7 Combined

Exports to Global South

China's exports to Belt & Road Initiative countries now exceed its combined exports to the US, EU, and Japan.

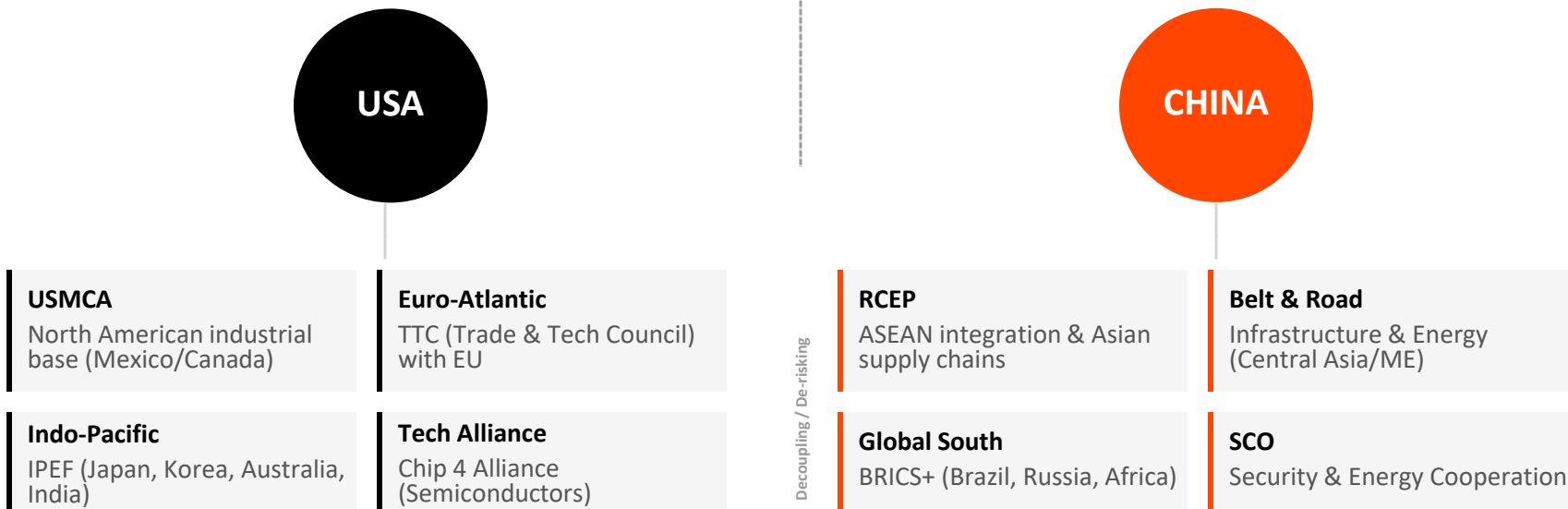
New Reality

ASEAN has replaced the EU and US as China's largest trading partner, creating a distinct Asian economic bloc.

The Emerging Bipolar Trade Architecture

From Global Integration to Hub-and-Spoke Fragmentation

“The WTO ‘Single Grid is being replaced by two parallel operating systems with distinct rules and standards.”



Strategic Logic

- “Friend-shoring” & Security-First
- High Labour & Environmental Standards
- Exclusion of “Foreign Entities of Concern”

Strategic Logic

- “Dual Circulation” & Commodity Security
- Infrastructure-for-Resources
- Non-interference & Development Focus

Transmission to the Financial System: Five Channels

| Trade Fragmentation Is Not Just Real Economy — It Rewires Finance

01 Dollar Liquidity Contraction

Global trade is the primary mechanism for distributing US dollars to the rest of the world. As trade growth slows, **structural USD shortages** emerge in Emerging Markets, forcing deleveraging.

02 Investment Fragmentation

FDI no longer chases pure efficiency; it chases geopolitical alignment. Capital flows are bifurcating into “US-aligned” and “China-aligned” blocs, reducing global capital allocation efficiency.

03 Inflationary Bias

Deglobalisation removes the deflationary anchor of cheap labour and optimised supply chains. Central banks face a permanent **supply-side inflationary bias**, forcing higher structural interest rates.

04 Alternative Payment Rails

Sanctions risk drives the development of non-SWIFT infrastructures (CIPS, mBridge, SPFS). Payment systems are shifting from a global utility to **strategic national assets**.

05 Stablecoin Adoption

As local currencies weaken due to trade shocks, demand for “digital dollars” (stablecoins) rises in the Global South as a hedge, creating a **shadow dollarisation** effect.

The Digital Rewiring: Tokenisation and the 24/7 Market

Changing the Fundamental Physics of Financial Transactions

The T+2 World

Settlement Cycle

Delayed (T+1 / T+2)

Market Access

Business Hours (Mon-Fri)

Infrastructure

Siloed Ledgers & Reconciliation

Risk Management

End-of-Day Batch Processing

Systemic Implications

The Atomic World

Settlement Cycle

Atomic (Instant / T+0)

Market Access

Continuous (24/7/365)

Infrastructure

Unified Programmable Ledger

Risk Management

Real-Time Programmatic Margin

Price Discovery

Elimination of “opening gaps”. News is priced instantly, reducing overnight volatility accumulation but increasing intraday speed.

Capital Efficiency

Atomic settlement eliminates counterparty credit risk during the settlement window, freeing up trapped collateral.


Automated Liquidation

Smart contracts execute margin calls without human forbearance, potentially creating cascading liquidity spirals.

Institutional DeFi: Efficiency with Compliance

Bridging the Gap Between Permissionless Innovation and Regulatory Safety

Feature	Traditional Finance (TradFi)	Institutional DeFi
Settlement Cycle	T+2 Days (Delayed) Requires clearing & settlement buffers	Atomic (T+0 / Instant) Delivery vs. Payment (DvP) in one transaction
Reconciliation	Manual & Duplicative Each bank maintains its own ledger	Unified Ledger Single source of truth; no reconciliation needed
Intermediaries	Multiple Layers Custodians, CCPs, CSDs, Transfer Agents	Smart Contracts Code automates the lifecycle events
Compliance	Ex-Post Reporting Checks happen after the trade	Embedded Identity Whitelisted wallets; compliance baked into the token


The “Permissioned Pool” Concept: Institutional DeFi uses public blockchain technology (for efficiency) but restricts access to known, KYC-verified participants (for compliance), creating a “walled garden” on the open internet.

CBDCs vs. Stablecoins: A Battle for Monetary Infrastructure

Two Diverging Models for the Future of Digital Money

Private Sector (Stablecoins)

Core Logic

“Privatised Seigniorage”

Mechanism: Tokenised commercial bank money or asset-backed liabilities.

Dominance: >99% are USD-denominated (USDT, USDC), effectively extending "Digital Dollarization".

Primary Use: Crypto-trading settlement, cross-border payments in weak currency regimes.

Public Sector (CBDCs)

Core Logic

“Monetary Sovereignty”

Mechanism: Direct liability of the Central Bank (Digital Cash).

Examples: e-CNY (China), Digital Euro (ECB), Sand Dollar (Bahamas).

Primary Use: Protecting payment resilience, financial inclusion, and countering foreign digital currency encroachment.

Liability Structure

Private Firm / Reserve Assets

VS

Central Bank Balance Sheet

Innovation Driver

Permissionless Composability (DeFi)

VS

Safety & Policy Control

Primary Risk

Run Risk / De-pegging

VS

Privacy / Disintermediation

The Regulatory Reconceptualisation

Digitalization Forces a Rethink of the Ontological Foundations of Regulation

The Legal Entity

The Old Axiom

“Regulation targets the firm (Legal Person). The firm holds the assets and bears the liability.”

The Digital Reality

DAOs are software, not companies. There is no CEO to jail, no headquarters to raid, and no distinct legal personality.

Question: How do you sanction a protocol that runs autonomously?

The Transaction

The Old Axiom

“A transaction is a discrete event between two identifiable parties at a specific point in time.”

The Digital Reality

Smart contracts enable atomic composability. Flash loans exist for 13 seconds, borrowing millions with zero collateral.

Question: Is a flash loan a credit event or a software function?

The Jurisdiction

The Old Axiom

“Law is territorial. Authority ends at the national border.”

The Digital Reality

The ledger is ubiquitous. Validators are distributed globally. The code executes identically in New York and North Korea.

Question: Whose law applies to a contract executed on 10,000 nodes simultaneously?

The Shift: From “Same Business, Same Risks, Same Rules” to “Same Risk, Same Outcome”

Module III

Hong Kongs Financial Regulatory Architecture

A World-Class Regime Under Geopolitical and Structural Stress

Key Questions This Module Answers

How is Hong Kong's regulatory architecture structured?

How does Hong Kong compare on international compliance (Basel/IOSCO)?

What is the SFC's "ASPIRE" framework for securities regulation?

How does the Linked Exchange Rate System (LERS) function mechanically?

What are the specific geopolitical risks facing this architecture?

Hong Kong's Tripartite Regulatory Structure

A Sectoral Model Coordinated by the Council of Financial Regulators (CFR)

Council of Financial Regulators (CFR)

Chair: Financial Secretary | Focus: Cross-Sector Stability & Coordination

HKMA

Hong Kong Monetary Authority

Banking & Currency

Maintains the Linked Exchange Rate System (LERS), manages the Exchange Fund, and supervises banks.

Banking Ordinance (Cap. 155)

SFC

Securities & Futures Commission

Securities & Markets

Regulates securities and futures markets, licenses intermediaries, and enforces conduct standards.

Securities and Futures Ordinance
(Cap. 571)

IA

Insurance Authority

Insurance

Modern independent regulator (since 2017) overseeing insurers and intermediaries under a risk-based capital regime.

Insurance Ordinance (Cap. 41)

Note: Unlike the "Twin Peaks" model (UK/Australia) which separates prudential and conduct regulation, Hong Kong uses a "Sectoral" model where each regulator handles both for its industry.

Hong Kong's Basel Compliance: RCAP Assessment

A “Super-Equivalent” Regime Validated by Global Peers

BCBS Standard	RCAP Grade
Risk-based Capital (Basel III)	Compliant
Liquidity Coverage Ratio (LCR)	Compliant
Net Stable Funding Ratio (NSFR)	Compliant
G-SIB Framework	Compliant
Large Exposures Framework	Compliant

* “Compliant” is the highest possible grade in the Regulatory Consistency Assessment Programme (RCAP).

Why Such Strict Adherence?

1. The “Caesar’s Wife” Principle

As an international financial centre without a sovereign hinterland, Hong Kong must be “above suspicion”. Regulatory arbitrage is not a viable strategy for a hub that relies on global trust.

2. Structural Necessity

Under the Currency Board system, the HKMA cannot freely print money to bail out insolvent banks without risking the peg. Therefore, banks must hold higher self-insurance (capital & liquidity) than peers.

The SFC's ASPIRE Framework

| A Strategic Roadmap for Transforming Hong Kong's Capital Markets

- A Access**
Broadening market access for global issuers and investors through expanded Connect schemes (Stock, Bond, ETF, Swap).
- S Safeguards**
Maintaining world-class investor protection (e.g. HKID regime) to ensure market integrity remains a competitive advantage.
- P Products**
Diversifying beyond equities into derivatives, ETFs, REITs, and RMB-denominated instruments to deepen the ecosystem.
- I Infrastructure**
Modernising trading and settlement platforms (e.g. FINI for IPOs) to enhance efficiency and reduce funding costs.
- Re Relationships**
Deepening regulatory cooperation with Mainland authorities (CSRC) and global standard-setters (IOSCO leadership).

Hong Kong's Digital Asset Framework: Frontier Regulation

A Comprehensive Ecosystem Covering Trading, Money, and Infrastructure

Trading Layer

Virtual Asset Trading Platforms (VATP)

Mandatory Licensing

Under **AMLO (Cap. 615)**, all centralised exchanges operating in HK must be licensed by the SFC.

Investor Protection

Retail access limited to large-cap tokens. Strict suitability checks and knowledge assessments required.

Asset Custody

98% of client assets must be held in **cold storage**. Insurance coverage required for 50% of cold / 100% of hot wallet assets.

Monetary Layer

Fiat-Reference Stablecoins (FRS)

The FRS Regime

New legislation requiring issuers to be locally incorporated and licensed by the HKMA.

Reserve Backing

Must hold high-quality, highly liquid reserve assets matching the par value at all times.

Segregation

Reserve assets must be segregated from the issuer's own funds to protect holders in insolvency.

Infra Layer

CBDC & Tokenisation

Project mBridge

Multi-CBDC platform for cross-border payments, solving the correspondent banking bottleneck.

Project Ensemble

Wholesale CBDC (wCBDC) sandbox to support settlement of **tokenised deposits** and real-world assets.

e-HKD Pilot

Exploring retail use cases including programmable payments and offline transactions.

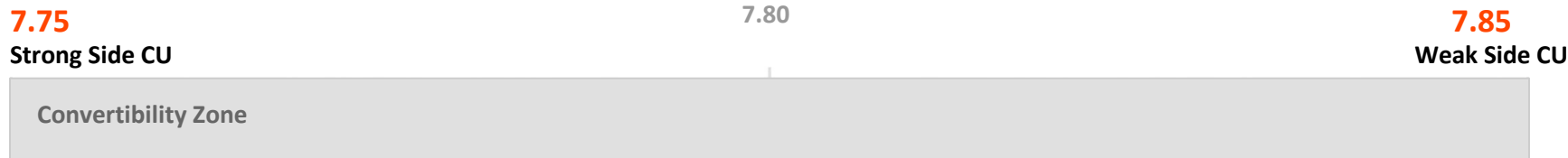
Global Digital Asset Regulatory Comparison

Hong Kong's Comprehensive Licensing Regime vs. Global Peers

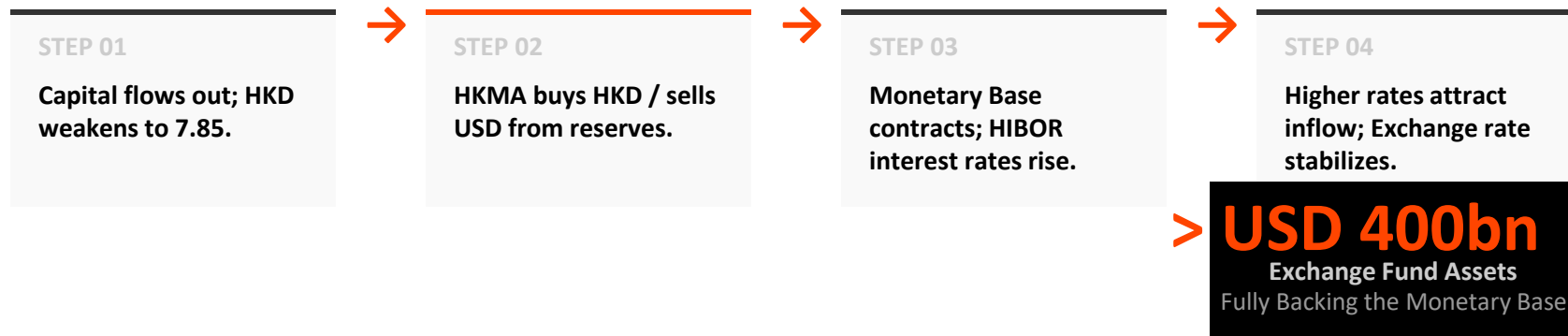
Hong Kong	EU	United States	Singapore	China
Philosophy Comprehensive Licensing ("Same Business, Same Risks")	Philosophy Harmonised Code (Single Market)	Philosophy Enforcement-Led (Regulation by Litigation)	Philosophy Risk-Focused (Prudential & Conduct)	Philosophy Prohibition (Financial Stability)
Framework VATP Regime (AMLO) + Stablecoin	Framework MiCA (Markets in Crypto-Assets)	Framework Patchwork (SEC, CFTC, State Money Transmitter)	Framework Payment Services Act (PSA)	Framework 2021 Ban on Trading & Mining
Retail Access Allowed (Large cap tokens only, strict suitability checks)	Retail Access Allowed (With extensive disclosure requirements)	Retail Access Allowed (But exchanges face lawsuits)	Retail Access Discouraged (Restricted marketing, high friction)	Retail Access Banned (Criminalised)
Key Differentiator Only jurisdiction with a clear pathway for retail government hub push	Key Differentiator Passporting rights across 27 member states.	Key Differentiator Deepest liquidity but highest regulatory uncertainty.	Key Differentiator Focus on institutional/wholesale use cases.	Key Differentiator Focus on industrial blockchain, not finance.

The Linked Exchange Rate System (LERS)

| A Currency Board System Anchored to the US Dollar since 1983

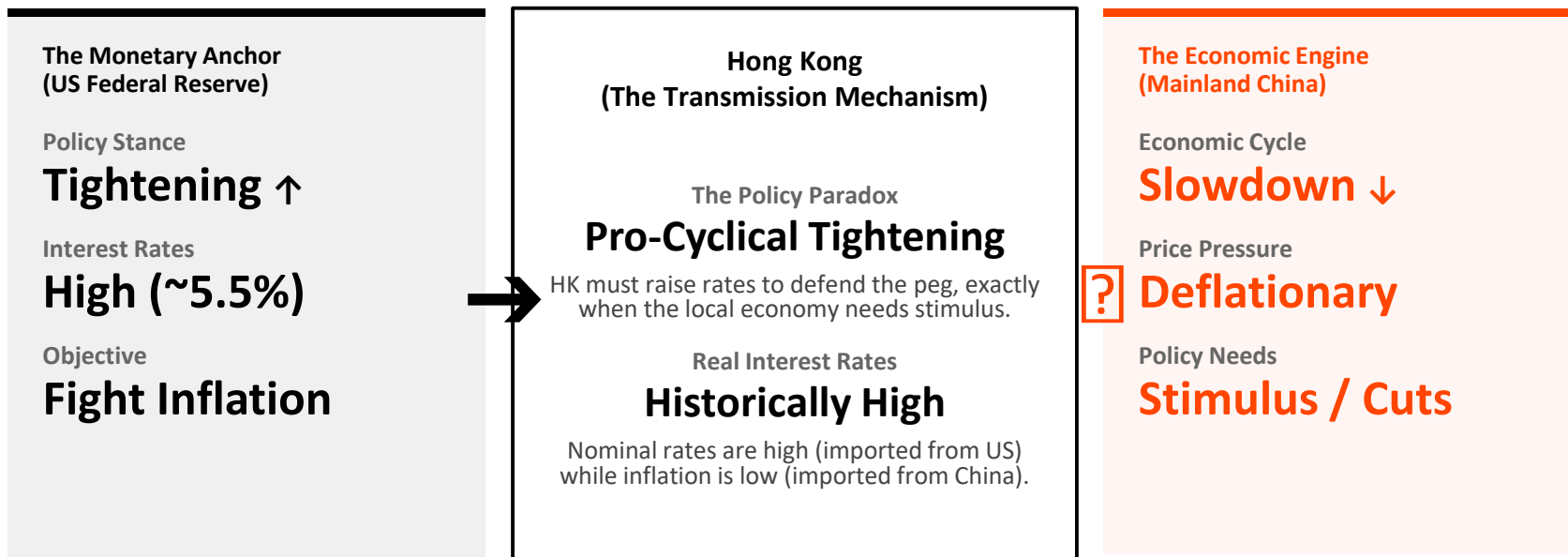


Automatic Adjustment Mechanism (Weak Side Example)



The LERS Under Structural Stress: The Diverging Cycles Problem

The Tension Between Imported Monetary Policy and Domestic Economic Reality



“Hong Kong is importing US monetary tightness into a China-correlated economic slowdown, creating a ‘double whammy’ for asset prices.”

Three Structural Geopolitical Risks

Existential Threats to Hong Kong's Role as a Global Financial Centre

01

US Secondary Sanctions

The “Nuclear Option”: The US Treasury could sanction HK banks for facilitating transactions with sanctioned entities (e.g. Russia, Iran, or Chinese military firms), cutting them off from the USD clearing system (CHIPS/SWIFT).

Potential Impact

Immediate cessation of USD clearing capabilities; systemic liquidity freeze.

02

LERS Capital Pressure

If the Mainland economy suffers a hard landing, massive capital flight could flow through Hong Kong. While the LERS is robust, extreme one-way flows could test the political will to maintain the peg's convertibility undertaking.

Potential Impact

Rapid depletion of Exchange Fund reserves; spike in HIBOR volatility.

03

Erosion of Autonomy

The *perception* among global firms that HK regulators (SFC/HKMA) are no longer operationally independent from Beijing. If the “One Country, Two Systems” firewall is seen as breached, the legal premium evaporates.

Potential Impact

Relocation of regional HQs; loss of “Common Law” valuation premium.

The Three-Way Tension: Strategic Synthesis

Hong Kong's Strategic Trilemma: Balancing Three Competing Imperatives

The Monetary Anchor (US Dollar)

Provides the financial stability and global convertibility required for an international financial centre.

The Constraint

**Imported monetary policy;
inability to devalue to offset
economic shocks.**

The Global Standard (Basel / IOSCO)

Provides the “trust architecture” that allows global capital to feel safe in Hong Kong.

The Constraint

**No “race to the bottom”; high
compliance costs; limited
regulatory flexibility.**

The Economic Engine (China)

Provides the real economy demand, IPO pipeline, and wealth management opportunities.

The Constraint

**Exposure to mainland economic
volatility and geopolitical friction.**

The Resolution: Diversification

Hong Kong cannot abandon any of the three. The only viable strategy is to serve as the **neutral interface** that translates China's economic needs into global financial standards, settled in hard currency.

Hong Kong's Strategic Positioning

Seven Strategic Pillars for a Resilient and Indispensable Future

IV

Key Questions This Module Answers

What is Hong Kong's unique structural advantage in the new order?

How can HK cement its offshore RMB monopoly?

What is the strategy for becoming the global Digital Asset hub?

How do Trade Finance, Commodities, and Arbitration create a new ecosystem?

What is the role of Talent as the enabling condition?

Hong Kong's Unique Structural Position

The Only Jurisdiction in the World That Combines These Four Structural Attributes



Common Law System

The global language of commerce. Provides predictability, judicial independence, and contract enforcement trusted by Western capital.



Open Capital Account

Free flow of capital with no foreign exchange controls. Anchored by the LERS (USD Peg) for currency stability.

CN

Mainland Access

Exclusive “Connect” channels (Stock, Bond, Swap, Wealth) providing direct, two-way access to the world’s second-largest economy.

vs. Singapore: Similar Legal/Capital, but lacks the depth of direct Mainland Access and RMB liquidity.

The Super-Connector

UNIQUE INTERSECTION



Offshore RMB Hub

The world’s largest offshore RMB liquidity pool (>1 Trillion), enabling pricing, settlement, and financing in the rising global currency.

vs. Shanghai: Similar Access/RMB, but lacks Common Law and an Open Capital Account.

Pillar 1: Cementing the Offshore RMB Monopoly

| From a Passive Liquidity Pool to an Active Yield Curve

The Challenge: Hong Kong holds the world's largest offshore RMB liquidity pool, but deposits need productive investment assets to stay sticky.

**~1 Trillion
RMB**

Strategy 01

Building the Yield Curve

Regular issuance of sovereign RMB bonds by the Ministry of Finance (MOF) in Hong Kong to create a risk-free benchmark curve for corporate issuers.

Mechanism: Dim Sum Bonds

Strategy 02

The Hedging Toolkit

Allowing international investors to hedge interest rate risks associated with holding RMB bonds. Without hedging, long-term capital cannot enter.

Mechanism: Swap Connect (2023)

Strategy 03

Commodity Pricing

Moving beyond financial speculation to real economy settlement. Denominating gold, lithium, and carbon credits in RMB to drive organic trade demand.

Mechanism: HKEX Commodities

Pillar 2: Becoming the Global Digital Asset Jurisdiction

Filling the Global Regulatory Vacuum with Certainty and Innovation

The Frontier (Goal)

Tokenised Real World Assets (RWA)

Creating the global venue for issuing and trading tokenised bonds, green energy credits, and private equity.

Key Project: Project Ensemble (Wholesale CBDC Settlement).

The Enabler (Payment Rail)

Regulated Stablecoins

Attracting global issuers (e.g., Circle, Tether competitors) to domicile in HK under a bank-grade reserve framework.

Key Legislation: Stablecoin Issuer Regime (2024).

The Foundation (Bedrock)

Legal Certainty & Custody

Defining digital assets as “property” under Common Law and enforcing the world's strictest custody rules (98% cold storage).

Key Advantage: Bankruptcy remoteness.

Why Now?

While the US pursues “Regulation by Enforcement” and Mainland China maintains a ban, a massive vacuum exists for a **fully regulated, compliant offshore hub**.

“Capital hates uncertainty. Hong Kong's primary product is Regulatory Clarity.”

Pillar 3: Trade Finance Digitisation

Bridging the USD 2.5 Trillion Global Trade Finance Gap

The Friction USD 2.5 Tn

Global Trade Finance Gap

The Paper Burden: Global trade generates 4 billion paper documents annually. Manual processing is slow, costly, and prone to fraud.

SME Exclusion: Over 50% of SME trade finance applications are rejected due to high compliance costs and lack of collateral visibility.

The Tech

eTradeConnect: A DLT-based platform connecting buyers, suppliers, and banks.

Single Source of Truth: Blockchain ensures data immutability, preventing “double-financing” fraud (where the same invoice is financed by multiple banks).

Programmability: Smart contracts can automate payment release upon delivery confirmation.

The Legal Key

The Barrier: Technology exists, but most jurisdictions still require “wet ink” signatures for a Bill of Lading to be a document of title.

The HK Advantage: Hong Kong is among the first common law jurisdictions to adopt the **UNCITRAL Model Law on Electronic Transferable Records (MLETR)**.

Strategic Impact

Gives electronic documents the same legal status as paper. HK becomes the “Digital Legal Hub” for global supply chains.

Pillar 4: Greater Bay Area Integration

Leveraging the World's Most Complete Supply Chain Cluster

Shenzhen

Innovation & R&D (0 to 1)



Guangzhou / Dongguan

Advanced Manufacturing (1 to 100)



Hong Kong

Capital & Global Access (IPO)

“Front Finance, Back Tech” — The new model replacing “Front Shop, Back Factory”.

01 The IPO Pipeline

Capturing the massive wave of “Hard Tech” unicorns emerging from the GBA who need international capital but face barriers in US markets.

02 Wealth Management Connect

Tapping into the savings of 86 million GBA residents. Allowing mainland investors to buy HK-domiciled funds, creating a massive new AUM source.

03 Supply Chain Finance

Using Hong Kong’s legal certainty to digitise and finance the complex trade flows of the GBA export engine (e.g. via the eTradeConnect platform).

86 Million Population
USD 1.9 Tn GDP (Approx.)
1 Hour Living Circle

Pillar 5: Commodity Trading and Pricing Hub

Capturing Pricing Power: From “Price Taker” to “Price Maker”

Hard Commodities (Metals)

The Strategic Logic

China consumes ~50% of global base metals but prices them in USD. This creates FX risk and strategic vulnerability.

The Execution

Leverage HKEX’s ownership of the **London Metal Exchange (LME)** to launch RMB-denominated futures contracts for Gold, Copper, and Lithium.

New Commodities (Carbon)

The Strategic Logic

Carbon credits are the asset class of the transition. Asia lacks a unified, trusted pricing center for Voluntary Carbon Markets (VCM).

The Execution

Scale the **Core Climate** platform to connect global ESG capital with Mainland decarbonisation projects, setting the “Asian Standard” for carbon pricing.

Key Strategic Asset

HKEX Ownership of LME

The acquisition of the London Metal Exchange (2012) provides the critical infrastructure to shift global pricing gravity Eastwards.

Pillar 6: International Arbitration

Leveraging Common Law Neutrality for the New Trade Architecture

The Bedrock

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Countries recognize Hong Kong arbitration awards under the **New York Convention**.

“The only Common Law jurisdiction within China, offering the familiarity of Western law with the enforcement power of Chinese sovereignty.”

01 Smart Contract & Digital Disputes

“Code is Law” until it breaks. Hong Kong is positioning itself as the specialized venue for resolving disputes in DeFi, DAO governance, and tokenised assets, where traditional courts lack technical competence.

02 The BRI “Demilitarized Zone”

As global trade decouples, Western firms engaging in Belt and Road Initiative (BRI) projects require a neutral venue. Hong Kong offers Western legal standards on Chinese soil—a unique compromise.

03 Cross-Border Insolvency

The 2021 Cooperation Mechanism allows Hong Kong liquidators to be recognized in Mainland courts (and vice versa). This is critical for restructuring massive Mainland corporate debts (e.g. Property Developers) with offshore bonds.

Pillar 7: Talent and Human Capital

Winning the Global War for Talent in a Post-Covid World

Strategy 01

The Magnet (Attraction)

Aggressively recruiting high-income professionals and top university graduates to reverse the emigration trend.

Key Initiative

Top Talent Pass Scheme (TTPS)

Strategy 02

The Pipeline (Cultivation)

Leveraging Hong Kong's 5 Top-100 Universities to generate "Deep Tech" talent and converting research into commercial ventures.

Key Initiative

InnoHK Research Clusters

Strategy 03

The Ecosystem (Retention)

Maintaining the "Hong Kong Premium": Low tax (15%), cosmopolitan lifestyle, and unparalleled connectivity to Asia.

Key Initiative

Family Office Tax Concessions

The Reality Check

Despite the "Brain Drain" narrative, the TTPS has approved over **50,000 applications** in its first year, signaling strong demand from global and mainland talent to access the HK ecosystem.

Implementation Framework

Sequencing and Prioritisation: A Phased Roadmap to 2030

2024 - 2025

Foundation

Legislation: Enact Stablecoin Issuer Ordinance and update Cybersecurity laws.

Infrastructure: Launch mBridge MVP and Project Ensemble Sandbox.

Connectivity: Expand Swap Connect to include more derivatives.

2026 - 2028

Expansion

Scaling: Onboard global stablecoin issuers and scale tokenised bond issuance.

Integration: Full implementation of GBA Wealth Connect 2.0 (higher quotas).

Markets: Launch RMB-denominated Lithium and Copper futures on LME/HKEX.

2029 - 2030

Leadership

Standard Setting: Export HK's "Regulated Web3" model to other jurisdictions.

Dominance: Establish HK as the primary pricing center for Asian Carbon Credits.

Maturity: Digital HKD becomes a standard settlement instrument for retail.

2030 Strategic KPIs

> 2 Trillion > 500 Billion Global #1

Offshore RMB Pool

Digital Asset Market Cap

Green Bond Issuance Hub

Risk Factors and Mitigation

Navigating the Headwinds to Secure the Strategic Vision

Geopolitical Risk US Sanctions & Decoupling

Strategy: Parallel Infrastructure

- ▶ Accelerate development of non-USD payment rails (mBridge) and deepen the offshore RMB ecosystem to reduce systemic reliance on CHIPS/SWIFT.

Competitive Risk Rise of Singapore / Dubai

Strategy: Unique Alpha

- ▶ Focus on “China Access” products (Connect Schemes) that competitors cannot replicate. Position HK as the *only* place to trade China yield.

Regulatory Risk Perception of Autonomy Erosion

Strategy: Judicial Visibility

- ▶ Maintain high visibility of Common Law judgments and foreign judges.
- ▶ Ensure digital asset regulation remains distinct from Mainland bans.

Talent Risk Brain Drain & Skill Gap

Strategy: Aggressive Attraction

- ▶ Leverage the “Top Talent Pass Scheme” and tax incentives to attract fintech and family office talent, replacing outflows with new inflows.

The Strategic Synthesis: Hong Kong as the Indispensable Bridge

A Neutral Infrastructure Layer for a Polarized World



“In a decoupled world, the value of a secure, neutral, and compatible interface increases exponentially. Hong Kong is the API that allows two incompatible operating systems to talk.”

Conclusion: The Window of Opportunity Is Finite

Hong Kong Must Act with Speed, Precision, and Commitment

01 Execute with Speed

Move from “Consultation” to “Implementation”. The regulatory sandbox phase must rapidly transition to live market infrastructure (e.g. Stablecoins, mBridge).

02 Leverage the Hinterland

Fully integrate with the Greater Bay Area. The “Super-Connector” role only works if the connection to the mainland engine is seamless and high-bandwidth.

03 Rebuild Confidence

Aggressively market the “One Country, Two Systems” reality. Legal certainty is the product; global trust is the currency.

“Hong Kong’s future is not to be just a gateway, but the operating system for the new Asian financial order.”

The Horizon

2030

The global financial architecture is being rewritten **now**. By 2030, the new rails (CBDCs, Tokenisation, RMB) will be set. The window to define standards is closing.

Lecture Summary: The Coherent Argument

| From First Principles to Future Strategy



The Foundation

Financial regulation is rooted in enduring market failures (Externalities, Asymmetry), but the global standard has evolved from simple capital ratios (Basel I) to a complex, holistic risk framework.



The Transformation

The global order has fractured. We have moved from “Hyper-Globalisation” to a “Bipolar Financial Architecture” driven by geopolitical decoupling and digital disruption (DeFi/Crypto).



The Context

Hong Kong maintains a world-class, “super-equivalent” regulatory regime but faces unique structural stress as the “transmission gear” between diverging US and Chinese cycles.



The Strategy

To thrive, Hong Kong must pivot from a passive gateway to an active “Super-Connector”, building the neutral infrastructure (RMB, Tokenisation, Law) that allows the two systems to interoperate.

Discussion Questions

| Critical Thinking on Regulation, Strategy, and Geopolitics

01 Is the Linked Exchange Rate System (LERS) still the optimal monetary anchor for Hong Kong?

Consider the “Impossible Trinity”: Can HK sustain a USD peg while its economic cycle is increasingly correlated with China and decoupled from the US?

02 Can “Same Business, Same Risks, Same Rules” truly apply to Decentralised Finance (DeFi)?

If a protocol has no central intermediary to license, does applying traditional securities law effectively ban the innovation? Is HK’s approach too conservative or appropriately prudent?

03 In a bipolar world, is the “Super-Connector” strategy a relic of the past?

If the US and China actively decouple, does the “Bridge” become a choke point? Or does the need for a neutral “air-gap” interface make HK more valuable than ever?

Class Exercise

Split into two groups: Group A (Regulators) prioritising stability; Group B (Fintech CEOs) prioritising innovation. Debate Question 02.

Key References and Further Reading

Foundational Texts and Official Reports

International Standards

Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems

Basel Committee on Banking Supervision (BCBS), Bank for International Settlements.

Objectives and Principles of Securities Regulation

International Organization of Securities Commissions (IOSCO).

Key Attributes of Effective Resolution Regimes for Financial Institutions

Financial Stability Board (FSB).

The Structure of Financial Supervision: Approaches and Challenges in a Global Marketplace

Group of Thirty (G30).

Hong Kong Strategy & Policy

Money and Banking in Hong Kong

Hong Kong Monetary Authority (HKMA).

Strategic Priorities for 2024-2026

Securities and Futures Commission (SFC).

Policy Statement on Development of Virtual Assets in Hong Kong

Financial Services and the Treasury Bureau (FSTB), 2022.

Hong Kong as a Global Hub for Digital Assets

Financial Services Development Council (FSDC) Research Papers.

Project mBridge: Connecting Economies through CBDC

BIS Innovation Hub & HKMA.