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Hong Kong and Singapore: What it takes to be a leading crypto hub

The Chinese territory is liberalising retail cryptocurrency trade to encourage crypto trading platforms to set up operations while the South-east Asian country is focusing on digital asset innovations. BY WOO JUN JIE

MUCH ink has been spilled over the impending competition between Hong Kong and Singapore to be Asia's cryptocurrency hub.

A recent article in the *Financial Times* was provocatively titled "*Hong Kong takes on Singapore for Asia's crypto crown*", while the *South China Morning Post* declares that "*Singapore's tighter cryptocurrency rules open sector to Hong Kong, other Asian rivals*". One reason for the perceived rivalry was that both cities were hosting fintech conferences around the same time, earlier this month (November).

While it is always tempting to conceive of a head-to-head competition between Hong Kong and Singapore, the reality is a little more complex.

First, the two financial centres cater to different markets. While Hong Kong is well regarded as the main gateway to China, Singapore has established strong links with South-east Asia and beyond.

Second, the two cities enjoy differentiated and complementary strengths. While Hong Kong is known for its deep capital pools and strong banking sector, Singapore has established itself as a leading hub for wealth management, fintech and sustainable finance.

This complementarity in the two financial hubs, coupled with strong trade relations between them, has led Health Minister Ong Ye Kung to characterise the Hong Kong-Singapore relationship as one of "mutual symbiosis".

The same can be said of the digital asset space.

While Singapore discourages retail trading of cryptocurrencies, it has chosen to focus on "upstream" digital asset innovations such as blockchain. For Hong Kong, rapid liberalisation of retail cryptocurrency trade will no doubt bring about greater vibrancy and opportunities in "downstream" digital asset trading.

Crypto hub: DeFi-ing territory?

But what does it mean to be a crypto hub? For Hong Kong, the focus has been on encouraging retail trade of cryptocurrencies by encouraging crypto trading platforms to set up operations in the territory. This will most certainly attract more crypto platforms to Hong Kong. But it remains unclear whether the economic gains of crypto transactions will accrue to the city, or whether the costs of disruption to traditional banking and finance can justify these gains.

It is important to note that cryptocurrency functions differently from, and is in fact often seen as anathema to, traditional banking and finance.

With transactions taking place anonymously on decentralised blockchains in the digital space, cryptocurrency has been seen as a potential disruptor of traditional financial institutions. This decentralised nature of cryptocurrency and blockchain has led to its characterisation as decentralised finance, or "DeFi".

In the DeFi world, financial transactions can take place anonymously and in fractional amounts over the blockchain. DeFi transactions are also not rooted in any particular geographical location, taking place instead in digital space. It is for these reasons that early proponents – often known as "cypherpunks" – frequently thought of cryptocurrency as a way to bypass traditional financial institutions.

Such disruptions can also pose immense risks to ordinary citizens. The recent collapse of crypto exchange FTX is yet another addition to a growing string of high-profile failures among crypto startups and platforms.

Health Minister Ong Ye Kung has characterised the relationship between Hong Kong (above) and Singapore as one of "mutual symbiosis". PHOTO: BLOOMBERG

Such risks had prompted Monetary Authority of Singapore (MAS) managing director Ravi Menon to describe cryptocurrencies as "highly hazardous for retail investors". Menon has also made it clear that the MAS is keen on promoting digital asset innovations with transformative economic potential but discourages risky speculation in cryptocurrency.

Racing upstream

Much of the current discourse on Hong Kong-Singapore competition is based on a traditional understanding of global finance, also often known as "TradFi". TradFi refers to a financial system that is led and dominated by mainstream banks and other major financial institutions such as fund managers, payments companies and insurers, among others. The key defining feature of TradFi is a focus on the centralisation of financial activity within a given jurisdiction, or what urban scholars such as Saskia Sassen term "clustering" and "agglomeration".

Agglomeration occurs when financial and business activities become concentrated within a particular jurisdiction, giving rise to an expansion in both jobs and opportunities. Given these agglomeration dynamics, cities seeking to transform themselves into financial hubs have tended to rely on loosening financial regulations to attract banks and financial institutions seeking out profit opportunities.

Competition among financial hubs in the TradFi world is therefore really a matter of regulatory competition; a process of financial centres trying to outdo each other by loosening regulations. As one can imagine, the unfortunate consequence of regulatory competition is often a deterioration of regulatory standards across the board. It is for this reason that regulatory competition is often described by economists as a "race to the bottom".

Divergent paths

One would be hard pressed to find signs of regulatory competition in Hong Kong and Singapore. While Hong Kong may have loosened some regulations pertaining to retail crypto, Singapore has instead tightened these regulations and chosen to focus on upstream innovations instead.

Even as cryptocurrency trade continues to be beset with risks and failures, digital asset innovation will no doubt be here to stay.

Singapore's focus on digital asset innovations rather than crypto trades will help it to bypass some of the conundrums and risks that have emerged in the digital asset sector. At the same time, this focus on technology and innovation can help to integrate elements of TradFi and DeFi.

For instance, the MAS recently announced an industry pilot under its Project Guardian that explores potential DeFi applications in wholesale funding markets, in collaboration with DBS Bank, JP Morgan and SBI Digital Asset Holdings.

While two roads may have diverged on Hong Kong's and Singapore's digital asset journeys, the twain will no doubt meet in the larger scheme of things.

As characterised by Minister Ong, Singapore and Hong Kong will continue to enjoy mutual symbiosis through their respective roles in upstream and downstream digital asset activity.

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