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Bitcoin Association of Hong Kong (via telegram)
Fintech Association of Hong Kong (via slack)

Fellow compatriot:

Our company. Bitquant Digital Services conducts research and development of technology to facilitate the trading of virtual assets. Our research involves not only developing the technical aspects of virtual assets but also applied legal research in regulatory and legal frameworks that would advance the usage of virtual assets in Hong Kong.

We are developing the technology to tokenize a Hong Kong private company with a view of facilitating ownership transfers between a small number of private investors. The typical use case for our technology would be to manage assets within a family office or to organize a venture capital fund with close investors. Our company has extensive contacts in Africa, the Middle East, and South Asia and our technology is also intended to allow the cross-border securitization of assets to promote Belt and Road Initiatives.

As we do not intend to offer tokens to the Hong Kong public, our activities will not require licensing under the Securities Futures Ordinance. However, as we will create an electronic platform for token holders to exchange virtual assets, our activities would require us to become a licensed virtual asset service provider as defined by Schedule 3B of the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Ordinance 2022 (“AMLCFTO”).

We therefore will obtain a transitional VASP license under Schedule 3G of the AMLCFTO. In addition, we intend to obtain transitional licenses for responsible officers and registered representatives where such licenses are required. Furthermore, we are also actively involved with other small technology companies and exchanges and will assist them in obtaining licenses and participating in the formation of the regulatory framework for VASPs.

Furthermore, as a part of the cryptocurrency community in Hong Kong we have noted with great interest the recent publication of the Hong Kong Monetary Authority discussion paper on crypto-assets released on 31 January 2023.

We are therefore reaching out to the SFC to begin a dialogue concerning the content of this regulatory framework. We have several specific concerns.

While we appreciate the willingness of the Hong Kong financial regulators to engage with the financial community through the public consultation process, and look forward to participating in future public consultations, we are concerned that this process will be weighted toward views of existing well-established interests and companies and will give insufficient consideration to the long term impact on companies and technologies which do not exist.

More specifically, we are worried that a flawed regulatory structure will make it impossible for companies such as ours set up in Hong Kong to use blockchain technology in new and innovative ways. Traditionally, transitional provisions have been used to “grandfather” existing companies. However, we are concerned that a flawed regulatory structure will make it impossible for companies with new and creative uses of virtual assets to establish themselves in Hong Kong.

We are also concerned that regulation will discourage startups and overseas companies from setting up in Hong Kong and create a “chicken and egg” problem by which companies cannot form a business without a license and cannot get a license without a business. setting up in Hong Kong. Specifically, companies that do not exist using technologies that are have not been invented are not able to take part in the public consultation process, nor are small companies or companies that have not established themselves in Hong Kong.

We are concerned about cartelization and regulatory capture of the virtual asset industry, as entrenched and well capitalized interests may promote a regulatory framework that will make it impossible for new and innovative companies to set up in Hong Kong.

Finally, we are also concerned that policy based on the interests of existing companies and regulations will not take into account the technological, national security, and geopolitical implications of fintech policy in Hong Kong.

As part of our work with Belt and Road Initiative partners, we have seen the destructive effects of overregulation in other jurisdictions in what is commonly known as the “license raj” and we are committed to ensuring that these destructive effects of licensing do not occur in Hong Kong.

To prevent these negative outcomes, we will rely on the basic constitutional framework of the Hong Kong Special Administration Region of the People’s Republic of China. In beginning a dialogue with

the Securities and Future Commission, we wish to state our position on the constitutional framework within which new regulations are produced and what we believe to be our role and the role of financial regulators under the Basic Law and one country, two systems.

The constitutional framework of financial regulation in Hong Kong

The economic and political system of Hong Kong is based on the Basic Law of the Hong Kong Special Administration Region and the one country, two systems policy issued by the Central Government of the People's Republic of China. The People's Republic of China is unique in practicing the socialist system in the Chinese mainland and the capitalist system in Hong Kong.

Just as the Mainland authorities must perfect the socialist system, the one country two systems framework places a unique responsibility among we patriots in Hong Kong to promote and perfect the capitalist system for the good of the Chinese nation. The capitalist system of Hong Kong has historically played a vital role in the economic and political development of the People's Republic of China, and Hong Kong must promote and advance the capitalist system within the one country, two systems policy to promote and advance the economic, political, technological and national security interests of the Chinese people.

To perfect the capitalist system, the Hong Kong Special Administration Region of the People's Republic of China is unique among jurisdictions in that the freedom of capital movement has been incorporated as a fundamental constitutional right. Whereas other jurisdictions provide constitutional protection to the right of property, Hong Kong is unique in the world in providing constitutional protection to the free movement of capital.

- Article 112 - The Government of the Hong Kong Special Administrative Region shall safeguard the free flow of capital within, into and out of the Region.
- Article 115 - The Hong Kong Special Administrative Region shall pursue the policy of free trade and safeguard the free movement of goods, intangible assets and capital.

These constitutional principles limit the ability of the Hong Kong government to impose capital restrictions on Hong Kong residents. For example, we believe that Articles 112 and 115 would prevent the Hong Kong government to limit or restrict cryptocurrency transactions between Hong Kong residents and unlicensed exchanges outside of Hong Kong.

This limitation arises not only from the constitutional principles of free exchange of capital but also from the position of Hong Kong as a local government with the People's Republic of China without long-arm jurisdiction over other areas.

One welcome consequence of these restrictions on state action is that it means that should the regulatory framework on virtual asset service providers become too restrictive, that Hong Kong residents can "vote with their feet" and conduct transactions with unlicensed exchanges outside of Hong Kong. We see this aspect of Hong Kong law is beneficial prevents regulatory overreach on the part of local authorities. Because Hong Kong cannot force residents to use local exchanges and cannot interfere with the free flow of capital with overseas exchanges, the financial regulators must create a regulatory framework by which the benefits of being licensed in Hong Kong outweighs the negative aspects of licensing.

This aspect of Hong Kong law would limit the ability of financial regulators to interfere with the development and use of virtual assets within Hong Kong. However, it would not prevent financial regulators from adopting regulations that would limit the innovative uses of virtual assets with the resulting negative aspects to employment, economic growth, and national security. For this, we must rely on other aspects of the constitutional framework and for this we must examine the legal limitations that Articles 112 and 115 place on administrative entities within Hong Kong within the common law system of the HKSAR.

The standard of review for ordinary administrative decisions is *Wednesbury* reasonableness (*Associated Provincial Picture Houses Ltd. v Wednesbury Corporation* [1948] 1 KB 223) Under this standard the courts will only strike down an administrative action that has been authorized by the legislature only if it is so outrageous in its defiance of logic of accepted moral standards that no sensible person could have arrived at it.

However, when a constitutional right is involved the administrative agency must follow a different set of standards. Specifically, the agency must demonstrate the restriction of the right involved is proportional to the public policy objectives which the action attempts to achieve (*R v. Oakes* [1986] 1 SCR 103) (*Hysan*

Development Co Ltd v Town Planning Board [2016] 19 HKCFAR 372) (Kong Yunming v. Director of Social Welfare [2013] HKCFA 107) (Official Receiver v. Zhi Charles [2015] FACV 8/2015). As outlined in Hysan, this proportionality test would require determining whether the decision (a) is serving a legitimate aim; (b) rationally connected to the aim; and (c) no more than necessary in attaining the aim and (d) to weigh the detrimental impact of the decision against the societal benefits gained.

In Hysan, the Court of Final Appeals stated that the legal standard to determine necessity would depend on the specifics of the situation, and would take into account factors such as the significance of the right, the nature of the encroachment, whether the interference is discriminatory and the constitutional identity of the decision maker and would adopt a test based on reasonable necessity or manifest unreasonableness. We believe that in determining a framework for virtual asset service provider regulation, we are determining issues which involve the fundamental right of free flow of capital, and which encompass a new regulatory framework involving technology issues which are outside the ordinary expertise of the Securities and Futures Commission, and therefore the correct standard is reasonable necessity.

In addition to impacting the rights involving the free flow of capital, we believe that any regulatory framework for virtual asset service providers would impact Article 33 and the right of choice of occupation.

- Article 33 - Hong Kong residents shall have freedom of choice of occupation.

The key case for interpreting Article 33 involves Leung Sze Ho Albert v. Bar Council of the Hong Kong Bar Association [2015] CACV 246/2015. Although the Court of Appeals ruled against Leung and undertook a narrow reading of Article 33 on the basis of GA. v Director of Immigration [2014] 17 HKCFAR 60 which avoided a proportionality analysis. However, we believe that the narrow interpretation of Article 33 by the Court of Appeals is unsupportable given the subsequent decision in Hysan. Leung and the Bar Council settled their dispute before the case was heard by the Court of Final Appeals, and we believe that in light of Hysan that the Court of Final Appeals would have overturned the narrow interpretation by the Court of Appeals.

We therefore believe that in developing the regulatory framework for virtual asset service providers that the Securities and Futures Commission, must undertake a proportionality analysis of any measures that would limit the ability of Hong Kong residents to operate a virtual asset service.

In addition to the proportionality analysis, we believe that the concept of “margin of discretion” is also relevant in this matter. The Hong Kong courts have established that many issues involving resource allocations and priorities are best decided by the executive and the legislature and that in these situations the courts should defer to the judgment of the executive and legislature. (Fok Chun Wa & Anor v. Hospital Authority & Anor. [2012 2 HKC 413]) (Hysan Development Co Ltd v Town Planning Board [2016] 19 HKCFAR 372).

We take these decisions to mean that when an administrative measure is challenged for infringing on the proportionality principle, that the administrative agency must then demonstrate that those actions are consistent with the objectives and rationales stated by the executive and legislature. We can begin with these objectives by looking at the Basic Law which states

- Article 109 - The Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre.
- Article 118 - The Government of the Hong Kong Special Administrative Region shall provide an economic and legal environment for encouraging investments, technological progress and the development of new industries.

In contrast to negative rights such as Articles 33, 112 and 115 which impose a limitation on the government, the concept of margin of discretion would indicate where the Basic Law presents a goal for the Hong Kong government, the government has discretion as to how to undertake these duties, and in looking at how the government has used its discretion, we would need to look at the statements of both national and local officials.

In his speech of 1 July 2022, President Xi Jinping stated a list of objectives for the Hong Kong Special Administration Region. In order to implement these objectives Financial Secretary Paul Chan has made various policy releases indicating the intention of the Hong Kong government to transform Hong Kong

into a virtual asset hub. Given that the legislature and executive have stated the objectives of regulation, we believe that under the “margin of discretion” doctrine that goals and objectives be given priority in creating a regulatory framework for virtual asset service providers

As such we believe that in crafting the regulatory framework for virtual asset providers that the Securities and Futures Commission undertake the following constitutional test for crafting these regulations

- Does the regulatory framework pass the proportionality principle regarding any restrictions imposed which affect the exercise of the rights in Articles 33, 112, and 115? and
- If such a restriction of rights is necessary are these restrictions consistent with the goals and objectives stated in Articles 109 and 118 and outlined by the executive and legislatures of the Hong Kong Special Administration Region along with national goals and objectives outlined by the Central Government? Specifically if there is a restriction of rights, do these restrictions enhance Hong Kong’s role as an international financial center and as a virtual asset trading hub, and do that provide an economic and legal environment for encouraging investments, technological progress, and the development of new industries?

In most jurisdictions, the issue of constitutional rights and limitations are considered only after the legislation and regulations have been implemented and mainly consist of a court challenge seeking to overturn administration action. Although these mechanisms are essential to protect basic rights, we believe that they can lead to unnecessary confrontation and a substantial waste of time and energy that may be devoted to other matters. We note that in the landmark Hysan case, the Court of Final Appeals declined to resolve the case, but returned the case to the Town Planning Board after stating the relevant constitutional principles.

Therefore rather than focus on constitutional issues through confrontation after regulations have been adopted, we believe that these constitutional issues should be considered in a cooperative spirit as the regulations are being drafted with a view toward the legal standards established by the Hong Kong judiciary.

To create regulations that are compliant with the Basic Law which would allow us and companies similar to ours to continue operations, we would prefer not to create specific regulations which can quickly become out of date, but rather create a general regulatory framework that will remain relevant over long periods.

A small exchange exemption

To this end, we would propose a small exchange exemption under which an exchange that has fewer than 250 accounts or HKD 10 million assets under management would be subject to a different regulatory system which would take into account the limited impact that a small exchange would have on the Hong Kong market. We also propose that the SFC create a special registration system for responsible officers and registered representatives of small exchanges.

A small exchange exemption would be analogous to the private placement exemption. It would remove many of the possible conflicts between a regulatory framework and the constitutional requirements of the Basic Law. Where an exchange has a limited number of accounts or a limited amount of assets under management, it is unlikely that the exchange will have a market impact requiring strong regulation, and therefore under the constitutional principles which we have outlined earlier, there is no need to impose high levels of regulation.

In addition to reducing conflict between the SFC regulation and the Basic Law, we believe that a small exchange exemption would encourage both local startups and overseas companies to establish a presence in Hong Kong on a limited scale.

We also believe that a small exchange exemption would aid in the proper regulation of virtual asset service providers, as a start-up company or an overseas company seeking to enter the Hong Kong market, can quickly acquire a small exchange license. When the exchange seeks to expand operations, the SFC can decide whether or not to grant a general license based on the track record of the company as a small exchange.

Conclusion

We live in difficult and challenging times. Although the century of humiliation of our motherland is over,

we face new difficulties and struggles in achieving the great rejuvenation of the Chinese nation and the fulfilling of the Chinese dream.

In these efforts, we must adhere to the one country, two systems policy and the constitutional framework incorporated into the Basic Law. Just as the authorities in the Chinese mainland are responsible for building the socialist system, we in Hong Kong must spare no efforts in building the capitalist system. We must use our role as an international finance center to welcome people, capital, technology, and ideas from all corners of the world for the benefit of Hong Kong, the Chinese nation, and the entire world.

As a gift, the Hong Kong Special Administrative Region of the People's Republic of China has been granted special autonomy by the Central Government, and this gift places a responsibility on we who love Hong Kong and love China to use this autonomy for the betterment of our city, our nation and our world.

We are pleased to have presented our views to the SFC and look forward to continued dialogue on this matter, and we would like to request a face-to-face meeting through the SFC Fintech Contact point to begin discussions on these issues. We have provided our contact information in a private supplemental attachment.

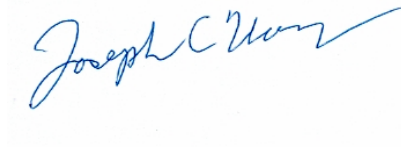
We have copied InvestHK and the Financial Services Treasury Bureau as are comments have relevance to the development of Hong Kong as a virtual asset hub. We are excited and optimistic about the opportunities available in Hong Kong, and we are particularly interested in working with InvestHK and FSTB to provide background information about the use and potential of virtual assets within Hong Kong.

We have also copied this letter to the Hong Kong Monetary Authority. Although we have no licensing matters before HKMA, we believe our views on the constitutional framework of financial regulation in Hong Kong will be relevant to policy regarding stablecoins. We have also copied this letter to the Chief Executive Policy Unit in the hopes that our views on the constitutional framework of financial regulation are relevant to policy in other areas.

In addition, we are circulating this letter within the financial community. We would be delighted if you would share this letter with any interested parties and give our permission to release this letter to any interested persons.

We believe that the unique constitutional structure of Hong Kong will require bold and imaginative solutions in the field of financial regulation. We cannot simply copy other jurisdictions but we must come with new and creative ideas, and we look forward to working with the Securities Futures Commission, InvestHK and other members of the fintech community in Hong Kong to come up with these solutions.

Yours Faithfully,

A handwritten signature in blue ink, appearing to read "Joseph C. Wang", with a long, sweeping horizontal stroke at the end.

Joseph Chen-yu WANG
Bitquant Digital Services

encl: CV of Manager