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Bitcoin Association of Hong Kong
Fintech Association of Hong Kong - Future Foundations Committee
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Fellow compatriots:

I am Joseph Chen-Yu WANG, self-employed proprietor of Bitquant Digital Services. My company is involved in the provisioning of technical services to cryptocurrency and blockchain companies, and I am writing to comment on the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill 2022, which will be the subject of a Bills Committee meeting on 29 July 2022.

In his speech on 1 July 2022, President Xi Jinping emphasized the importance of the One Country, Two Systems policy and the need to develop Hong Kong as a technology hub and international financial center. A vibrant and active virtual asset market is needed to meet these goals. However, the story of the virtual asset market in Hong Kong has consisted of initial success followed by lost momentum caused in part by misregulation.

The One Country, Two Systems policy places a special responsibility on patriotic forces within the Hong Kong Special Administration Region to develop its capitalist system to complement the socialist system of the interior of China. A strong capitalist system within Hong Kong will serve to improve the socialist system of the interior of China and a strong socialist system within the interior of China will create opportunities for the capitalist system of Hong Kong.

Unfortunately, rather than focusing on the initially successful policy using market-driven minimal-regulation capitalist mechanisms to regulate virtual assets, the focus of recent regulation has been to copy the state-

driven regulatory mechanisms of other jurisdictions such as the United Kingdom, Singapore, and the United States in ways that are unsuitable for Hong Kong. While heavy state regulation may be suitable for other regions, these policies are incompatible with the capitalist system as practiced in Hong Kong and have needlessly damaged the virtual asset industry.

In particular, because of the low-tax small-state policy of the HKSAR, administrative agencies are limited as to the resources and expertise that they can access. Hence, the recent history of virtual asset regulation in Hong Kong has been that of administrative agencies asserting power to regulate virtual assets yet then failing to make critical decisions in a timely manner. Moreover, the existing regulatory structure of Hong Kong focuses on the concerns of existing businesses and has no basis for representation of businesses that do not yet exist. Finally, there is no institutional mechanisms or incentives for the administration to make fundamental changes in regulatory policy in response to changing events.

In fact, there are strong incentives for regulators in Hong Kong to delay in making any decisions and to refuse permission for any new or innovative technologies. A regulator risks nothing by saying no, but risks everything if they say yes. Faced with regulators have no real incentive to approve any innovation, Hong Kong has witnessed an brain drain of talent and expertise in virtual assets to other regions.

Thus by blindly copying the regulatory frameworks of other jurisdictions, the regulators in Hong Kong have created regulatory uncertainty and gridlock, which has been highly damaging to Hong Kong's status as a virtual asset center and innovation-friendly jurisdiction. In the *History of the Peloponnesian War*, Thucydides quoted Pericles as saying "our city does not imitate but is an example to others." Unfortunately, the legacy of British imperial rule has created a system in Hong Kong by which administrative regulators are simply incapable of creating systems which do not merely imitate others, even though those systems are unsuitable for the capitalist system of Hong Kong.

In his speech, President Xi Jinping emphasized the need for the executive and legislative branches of the Hong Kong government to cooperate and check and balance each other. Therefore, we believe that the Legislative Council should play a much more active role in financial regulation with a view of limiting overregulation and promoting capitalist market mechanisms within the Hong Kong Special Administrative Region, and to provide democratic representation of sectors that are negatively impacted by financial overregulation but which do not have a communications channel to the financial regulators.

In most jurisdictions, the legislature places a passive role in financial regulation and the legislature effectively gives a blank cheque to the judicial and administrative agencies to carry out financial regulation. This results in regulation that is tailored for existing industries, but which can result in overregulation and the inability of regulators to respond to the stakeholders outside of the existing financial institutions. We are concerned that without the active involvement of the Legislative Council that Hong Kong will face issues of regulatory capture and rent-seeking behavior, which will negatively impact businesses that do not currently exist.

Given the negative impact of existing regulation, I believe that it is unwise to extend regulation to a new class of virtual assets and that Hong Kong would be better off with no new regulation on virtual assets. Nevertheless, I feel that given the regulatory uncertainty that a flawed bill may be better than no bill, and although I believe that the bill will damage the continued development of virtual assets in Hong Kong, I believe that this damage can be minimized with proper legislative oversight.

Therefore, I would propose a few measures which I believe will enable the Legislative Council to carry out its responsibility under the Basic Law and would appreciate if these issues are raised with the administration at the Bills Committee meeting on 29 July 2022.

- **Clarify the limits of the HKSAR to regulate non-Hong Kong entities and cross-border virtual asset transactions** The legislative record should make clear that the current legislative changes do not affect virtual asset service providers who are operating outside of Hong Kong and does not affect the ability of Hong Kong entities to access virtual asset service providers located outside of Hong Kong.

Under the Basic Law of Hong Kong and the One Country Two Systems policy, the Hong Kong Special Administration Region, as a local government of the People's Republic of China, does not have authority to directly regulate virtual assets service providers located outside of Hong Kong, and the courts have upheld limits on the long arm jurisdiction of administrative regulators in cases such as *Securities and Futures Commission v Isidor Subotic and Others*.

In addition, the HKSAR does not have the authority to limit the ability of Hong Kong entities to access virtual assets service providers outside of Hong Kong as this would constitute a disproportionate restriction on the free flow of capital, which is guaranteed by Articles 112 and 115 of the Basic Law, and would not be justifiable by any reasonable argument invoking the proportionality principle.

We are concerned that any lack of clarity regarding the scope of this legislation would lead non-Hong Kong providers to refuse to do business with Hong Kong entities, which would threaten the viability of Hong Kong as an international financial center. We would like clarification that while the Hong Kong Special Administration Region does have the power to regulate marketing to the general public that Articles 112 and 115 of the Basic Law prevent Legislative Council and the administration from placing limits on cross-border transactions in virtual assets, and that the current legislation does not seek to violate the Basic Law by doing so.

We are concerned that without such clarification that non-Hong Kong virtual asset service providers will simply refuse to provide services to Hong Kong entities such as our company. Should this occur, we would be forced to challenge the scope and constitutionality of the legislation through judicial review. Not only would this be a costly waste of time for both ourselves, the courts, and the Securities and Futures Commission, but this would add to regulatory uncertainty and create needless negative publicity for Hong Kong.

We hope that the Legislative Council can avoid this outcome by clarifying the scope of legislation in the drafting stage, by incorporating a common understanding of the limits of the legislation in the legislative record perhaps through members questions and that there is agreement by all stakeholders that given that Articles 112 and 115 of the Basic Law requires the free flow of capital, that the HKSAR cannot and does not seek to limit cross-border transactions in virtual assets by this legislation.

- **Clarify the initial set of regulations to reduce market disruption during the transition period and create institutional mechanisms to conduct legislative oversight over the SFC during and past the transitional period**

In the proposed explanation to Legislative Council, it is stated that the SFC intends to allow access to exchanges only to professional investors. Unfortunately, as the current virtual asset providers do provide exchange services to the general public, this is likely to lead to severe market disruption and without clarity as to what the proposed regulatory structure will be like, we are concerned that this will cause widespread abandonment of the Hong Kong market by existing service providers.

We have attached as a proposal for discussion a set of proposals which we believe will would minimize market disruption. Our proposal would have the Securities and Future Commission issue initial guidelines that would allow that allow virtual asset service providers to continue to offer to trade commonly traded virtual assets (CTVAs) to the general public.

Regardless of whether our proposal is accepted or not, we feel that it is essential for the Legislative Council to address the issue of market disruption during the transition period. We further believe that it is unwise for the Legislative Council to issue a blank cheque to the Securities and Futures Commission and that some institutional mechanism should exist for the Legislative Council to continue to exercise oversight over the SFC during and past the transition period to ensure that the SFC does not engage in overregulation of the virtual asset industry.

- **Give the power to amend the list of regulated activities to an office that can consider the national security implications of those amendments**

We propose that Section 53ZTL should be amended to give authority to amend Schedule 3B to the Financial Secretary rather than to the Secretary of Financial Services and Treasury on national security grounds.

It is vitally important to the national security of the People's Republic of China that Hong Kong maintains a strong virtual asset trading and technology ecosystem, as virtual assets allow the People's Republic of China to more effectively resist sanctions and economic coercion by foreign powers. We note that senior members of the Hong Kong government and of the Central Government are under foreign sanctions and are unable to conduct normal banking operations and that virtual

assets are essential for the People's Republic of China to counteract this form of economic blackmail.

The decision for which services are to be regulated has foreign policy, defense, and national security implications. Therefore, we believe that any decision to modify the list of regulated activities under Schedule 3B should be performed by an official who is a member of the Committee for Safeguarding National Security and may consult directly with the Central Government regarding the national security implications of virtual asset regulation. We believe that the current legislation grants the authority to modify Schedule 3B to an official who is insufficiently senior and that the power to modify Schedule 3B be given to the Financial Secretary rather than the Secretary of Financial Services and Treasury.

In closing, I have been disappointed at the missed opportunities and mistakes that have been made in virtual asset regulation in Hong Kong. However, as we are all committed to the economic prosperity of both Hong Kong and the People's Republic of China as a whole as part of the great rejuvenation of the Chinese nation, I believe that we can work together to learn from our mistakes and constructively express our opinions and disagreements in a rational and democratic manner.

I look forward to future dialogue concerning virtual asset regulation within the Hong Kong Special Administrative Region of the People's Republic of China.

Faithfully yours,

Joseph Chen-Yu WANG

encl: Proposed Guidelines on Trading of Commonly Traded Virtual Assets
Curriculum Vitae of Author