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April 11, 2024

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Re: Response to VA OTC Public Consultation

Fellow compatriots and dear friends:

I am Dr. Joseph Chen-Yu Wang, sole proprietor of Bitquant Digital Services and writing on behalf of my company in response to the public consultation request issued on 8 February 2024 by the Financial Services and Treasury Bureau. Our company has been very active in participating in public consultations, and a collection of our filings is available online.[1] including our most recent response to the public consultation regarding stablecoin regulation [2]

I wish to express my reservations about extending licensing to cover virtual asset OTC transactions. The proposed licensing regime will impact my constitutional rights under Articles 112, 115, and 118 of the Basic Law and also has national security implications concerning the ability of the People's Republic of China to withstand an external blockade or sanctions regime and to resist current efforts to deny the People's Republic of China access to external sources of capital and technology, and I do not believe that these issues have been adequately examined.

These issues directly impact me and my company. I am a computational astrophysicist who is currently developing supercomputing, web3, and blockchain projects, which are intended to advance the goals of the Circular Electron-Positron Collider project to be constructed during the 2030s. In addition, I am a contributor to many Web3 projects and am working to encourage talent and technology to come to Hong Kong. I have recently participated in several projects involving asset tokenization and blockchain fundraising, and I am dismayed that Hong Kong appears to be falling behind when it should be leading. I am concerned about the implications of this for the future development of the Chinese nation.

[1] https://github.com/joequant/bitquant-vasp/tree/main/filings

[2] https://github.com/joequant/bitquant-vasp/blob/main/filings/fstb-stablecoin-20240226.pdf

Approximately one decade ago, acting on the wishes of my deceased father, I returned to the motherland to participate in the great rejuvenation of the Chinese nation and the fulfillment of the Chinese dream. I am grateful to my ancestors for their tremendous sacrifice for the Chinese nation during its most difficult times. Out of gratitude for these sacrifices, I have committed myself to overcoming the difficulties caused by my father's instructions.

In my attempts to attract talent to Hong Kong, I have found strong dissatisfaction with the direction of Hong Kong's virtual asset policies. Hong Kong is under intense commercial competition for talent and business with other financial centers, and initially, Hong Kong was very successful at developing new virtual asset businesses with its light touch and business-friendly policies. However, as Hong Kong has moved away from those policies; it has become substantially less attractive as a business destination, and this has negatively impacted Hong Kong's viability as a virtual asset hub and the ability of the People's Republic of China to prevail in an era of geopolitical struggle.

I have found persons seeking to do business in Hong Kong are dissatisfied with the imposition of new licensing requirements. However, rather than attempt to change Hong Kong's regulatory framework, they have decided to "vote with their feet" and move operations elsewhere. Alternatively, they believe that the regulators will change direction only through the failure of Hong Kong regulation. Therefore, they are not participating in the policy discussions regarding virtual asset policy. They have moved operations elsewhere and have encouraged me to do so.

However, because of the instructions of my father, I cannot and will not leave Hong Kong. As I cannot leave, I must work with other patriotic forces to create an economic and legal framework for the Hong Kong Special Administrative Region that will enable us to carry our sacred duties to the motherland to advance the great rejuvenation of the Chinese nation by harnessing the power of new productive forces.

Thanks to the sacrifices of the Chinese nation, China is no longer the sick man of Asia, and our century of humiliation is over. However, we must resist any movement to return to those dark years. We absolutely cannot and will not return to the era of the Opium Wars, when China faced steamships and rifles with inferior technology and had an obsolete political and economic system that was unable to resist foreign invasion. In a world of geopolitical hostility, The current policies toward virtual assets in Hong Kong are critical for the development of technology. Technology is not only about machines but requires a legal and economic framework to support these developments.

Among patriotic forces in Hong Kong, there are differences of opinion in policy. However, the ultimate test of any constitutional system is whether it allows for differences of opinion and perspective to strengthen the nation rather than weaken it. Under the principle of patriots ruling Hong Kong, we can express differences of opinion and perspectives in a civil, rational, and democratic fashion, thereby allowing the Chinese nation to overcome its current challenges. Therefore, I welcome this opportunity to present my views and look forward to hearing alternative and conflicting views.

We note that the Chief Executive-in-Council must approve the introduction of new government bills, including any new legislation on virtual asset OTC regulation. As many of the members of the Executive Council are under sanctions from unfriendly foreign powers and have had difficulty in obtaining banking services similar to the challenges that we have faced, we hope that they will be sympathetic to our efforts at creating an alternative payments system through virtual asset OTC providers, and that they will share our skepticism of efforts to restrict the activities of these providers through licensing.

In examining the correct policies regarding virtual assets in Hong Kong, we must begin with an examination of the constitutional structure of the Hong Kong Special Administrative Region of the People's Republic of China.

Q1 Do you agree that the regulation of VA activities should be widened to cover OTC trading of VA?

The proposed legislation has not sufficiently justified the need to limit constitutional rights

We strongly object to the proposed measures as we believe that the current proposals have grave constitutional and national security consequences that have not been adequately examined.

We note that in a 20-page document, the public consultation devotes merely one paragraph to justifying the need to limit constitutional rights in Hong Kong by licensing VAOTC. We believe this is insufficient,

and without further justification for the need for licensing, this scheme will not survive judicial review.

We begin with the relevant articles in the Basic Law, namely Articles 112, 115, and 118:

> **Article 112** No foreign exchange control policies shall be applied in the Hong Kong Special Administrative Region. The Hong Kong dollar shall be freely convertible. Markets for foreign exchange, gold, securities, futures and the like shall continue.
> 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.
> **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.

We believe that the Hong Kong government is attempting a good-faith effort to develop virtual assets. However, we believe that the FSTB, HKMA, and SFC are making a severe error basing their virtual asset regulatory principles on a "same activity, same risk, same regulation" philosophy, which merely copies the regulatory practices of other jurisdictions without regard to preserving and enhancing the capitalist system of the Hong Kong Special Administrative Region. We believe that this philosophy is flawed and constitutionally untenable in Hong Kong.

Much of FSTB's approach to virtual asset regulation appears to be copying other nations' policies and practices and incorporating directives from international standards organizations. In particular, we have noted similarities between the approach of the SFC and HKMA have taken and the approach of the United Kingdom, which is currently considering new legislation and regulations concerning stablecoins. [3] [4]

Hong Kong's financial regulatory agencies, such as HKMA and SFC, were created during the period of the British administration of Hong Kong and carry over many of the traditions and practices of the United Kingdom. In other areas, such as freedom of expression, copying the laws of other nations may be sufficient to ensure compliance with the Basic Law [5], and indeed, the Hong Kong administration took the approach of referring to other common law jurisdiction in the recent deliberation of Article 23 legislation to avoid ICCPR and Basic Law challenges.

However, this approach to modeling Hong Kong's virtual asset regulation on that of the United Kingdom and implementing such rules based on recommendations from international standard bodies is untenable because of the differences in the constitutional structure between Hong Kong and the United Kingdom.

Firstly, the United Kingdom operates under a system of parliamentary sovereignty in which primary legislation is not subject to constitutional challenge without the consent of parliament itself. In Hong Kong laws passed by the National People's Congress are direct expression of sovereign powers and, therefore, cannot be reviewed for constitutionality by local courts [6]. However, the authority of the Legislative Council does not derive from fundamental sovereign powers but laws created by the National People's Congress and, hence, laws passed by the Legislative Council are subject to judicial review for conformance to the Basic Law under Article 158. Therefore, virtual asset legislation in Hong Kong is subject to constitutional review and limitations that do not exist for primary legislation in the United Kingdom.

More significantly, to advance the interests of the Chinese nation, the National People's Congress exercising the sovereign powers of the Chinese people have, through the Basic Law, elevated the principle of the free flow of capital to be a fundamental constitutional right in Hong Kong through Articles 112 and 115 of the Basic Law. These constitutional provisions are unique to Hong Kong and have profound implications for virtual asset regulation and make it impossible for Hong Kong to copy the legislative approach of the United Kingdom, as FSTB appears to be attempting to do.

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[3] Update on Plans for Regulation of Fiat-Backed Stablecoin - HM Treasury (2023 October 10)

[4] FCA DP23/4 Public Consultation on UK Regulation of Stablecoins

[5] HKSAR v. Ng Kung Siu and Another (1999) 2 HKCFAR 442

[6] Ng Ka Ling v Director of Immigration (No 2)

Under the laws of both England and Hong Kong, when a constitutional right is not engaged, administrative actions are only subject to the standard of "Wednesbury reasonableness" [7]. Under the "Wednesbury reasonableness" standard a governmental action is legally invalid only where it is so irrational that no reasonable person can have thought of it. [8] To justify the proposed licensing scheme under Wednesbury reasonableness, the government must merely show that there is some hypothetical connection between the bill and some public good. The public consultation document justifies the necessity for the proposed licensing system by briefly referencing consumer protection and the need to follow international standards. There has been no in-depth discussion of possible alternatives, nor has there been any discussion about the consequences and ramifications of this legislation. This level of discussion would be sufficient to establish Wednesbury reasonableness and establish the constitutionality of the proposed licensing scheme even if it were not primary legislation, but it is insufficient to establish constitutionality under the laws of Hong Kong.

Since the People's Republic of China assumed sovereignty over Hong Kong, the laws concerning individual rights in Hong Kong have diverged from the laws of the United Kingdom. Under the administration of the People's Republic of China, the courts in Hong Kong have introduced new concepts that have been influenced by the Canadian Supreme Court's jurisprudence on the Canadian Charter of Rights and Freedoms [9] as well as jurisprudence by the Australian High Court regarding Section 92 of the Australia Constitution [10] [11]. In addition, the courts in Hong Kong have also cited cases from the United Kingdom which have interpreted the European Convention of Human Rights, particularly Article 1 of the First Protocol, which protects property [12].

Although neither the Canadian nor Australian constitutions nor the European Convention on Human Rights contains rights analogous to Articles 112, 115, and 118 of the Basic Law, courts in Hong Kong have used these decisions as inspiration for how constitutional rights are to be implemented in a common law context.

Under the laws of Hong Kong, a legislative or administrative action must comply with the "proportionality principle" which is that the action which limits a constitutional right is valid only if the restriction on that right is proportional to the public good served [13] and the measures adopted to achieve some public good should interfere with constitutional rights as little as reasonably possible [14].

Moreover, under the "margin of appreciation" doctrine [15], the courts will exercise deference to the decisions of the executive and legislature concerning how to balance different social goals. However, one consequence of the margin of appreciation doctrine is that the executive and legislature cannot merely rubber stamp restrictions on individual rights. The judiciary will defer to the judgment of the executive and legislature as to how best to balance different social needs, but this deference requires that the executive and legislature consider and have attempted to address these issues.

These constitutional requirements mean that the deliberations on virtual asset regulation in Hong Kong must be very different from the the deliberations in the United Kingdom. In the current public consultation, the FSTB appears to be taking an approach which is permissible under English law, in which the administrative authorities can merely state a hypothetical connection between the measures and some public good, devise a strategy and then adopt legislation to implement that strategy. The envisioned process would have the basic strategy for virtual assets defined by administrative bodies and then limit the role of public consultations and Legco to merely polishing and ratifying the implementation of said strategy.

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[7] Associated Provincial Picture Houses Ltd v Wednesbury Corporation (1948) 1 KB 223

[8] I am aware of recent developments in administrative law in the United Kingdom that have relaxed the Wednesbury criterion due to influence by the Human Rights Act and the European Convention on Human Rights but these are beyond the scope of the letter

[9] R. v. Oakes [1986] 1 SCR 103

[10] Betfair Pty Ltd v. Western Australia [2008] HCA 11

[11] Cole v. Whitfield [1988] HCA 18

[12] see Sporring and Lonnroth v. Sweden IHRL 36 (ECHR 82)

[13] Hysan Development Co Ltd and Others v Town Planning Board (2016) 19 HKCFAR 372

[14] Chan Hei Ling Helen v Medical Council of Hong Kong [2009] 4 HKLRD 174

[15] Fok Chun Wa & Anor v. Hospital Authority & Anor [2012] 2 HKC 413

The United Kingdom takes this approach, but this approach is not constitutionally viable in Hong Kong. If the executive and legislature take this approach, the laws created would be subject to legal challenges upon enactment. The "margin of appreciation" doctrine places severe legal requirements on the executive and legislature. Although the courts will defer to the answers provided by the executive and legislature to certain questions, these questions cannot be neglected or avoided. Under UK rules, the government and legislature can ignore these questions, but under the laws of Hong Kong, the administration and the legislature cannot avoid answering these questions. Although the "measure of appreciation" will have the courts deferring to the government and legislature in answer these questions, the courts will not tolerate the government or the legislature ignoring such questions altogether.

Under Hysan, the Court of Final Appeals has established a four-step process for determining the constitutionality of actions under the Basic Law, and in the interests of administrative efficiency, it would be advisable to consider these questions before legislation is enacted. These four steps are:

- the restriction or limitation must pursue a legitimate aim;
- the restriction or limitation must also be rationally connected to that legitimate aim;
- the restriction or limitation must also be no more than was necessary to accomplish that legitimate aim; and
- Where an encroaching measure had passed the three-step test, the analysis should incorporate a fourth step, asking whether a reasonable balance had been struck between the societal benefits of the encroachment and the inroads made into the constitutionally protected rights of the individual, asking in particular whether the pursuit of the societal interest resulted in an unacceptably harsh burden on the individual.

On the third step the courts will use the context of the case to determine the margin of discretion to give to the executive or legislature. Where the government has some unique expertise, for example, the courts will defer to the decisions of the executive or legislature. In order to satisfy these steps of the proportionality analysis, the executive and legislature must answer additional questions based on the content of the proposed measures. Among the questions that executive and legislature **must** answer and **have not answered** before enacting this legislation are as follows:

> What is the actual aim of this legislation?

We believe that the stated goals in the public consultation fail even step one of the Hysan test. The stated purpose of this legislation is to implement the "same activity, same risk, same regulation" principle and to bring Hong Kong to compliance with directives issued by international standards bodies. However, these are not legitimate social aims that justify limiting individual rights. Specifically, there are *means* rather than *ends* and to justify a restriction on individual rights, one must argue for an end goal. The goals of reducing transnational crime, preventing fraud, protecting investors, and promoting international cooperation to increase Hong Kong's standing as an international financial center are legitimate aims. However, the goal of complying with a directive by some external body or creating regulatory consistency is not a legitimate public policy *goal* that would justify a restriction of rights.

> Will the proposed measures be successful at achieving its public policy goals?

This question addresses the second step of the Hysan proportionality test. In contrast to "Wednesbury reasonableness", the proportionality principle requires that when the state proposes that constitutional rights be limited to achieve a public good, that state must consider whether those measures will succeed in achieving that public good. This limits the possibility that bureaucratic and administrative mechanisms will create a situation where the policy fails to achieve the good envisioned, but the restrictions on individual rights remain.

For example, we note that the financial regulators in Hong Kong are incentivized to ensure that financial fraud does not originate from Hong Kong. Therefore, if the regulators in Hong Kong pass restrictive licensing in Hong Kong, with the result that Hong Kong residents are defrauded by persons operating overseas, the regulators in Hong Kong can argue that they have fulfilled their responsibilities, as they are not responsible for fraud committed against Hong Kong residents from areas they have no control over. This outcome is acceptable under the British test of "Wednesbury reasonableness".

However, when individual rights are involved, this approach is unacceptable. If there are measures that limit my freedom to trade virtual assets within Hong Kong, and the result of these measures are merely that fraudulent operators move off-shore, then this fact that the measures have not achieved the public good envisioned by the measures, which means that my rights have been restricted for no social benefit.

Furthermore, we note that in response to a scandal such as JPEx, the Hong Kong government and legislature may be under intense public pressure to "do something." However, a knee-jerk reaction to intense public pressure may result in bad public policy decisions that can exist for decades and may result in the loss of individual rights for no or negative social benefit, and therefore, these constitutional norms exist to prevent this outcome.

For example, we may argue that licensing will not protect the consumer but may *increase* the ability of scammers to harm the consumer. In a world where there is a mix of fraudulent and non-fraudulent businesses, a rigorous program of consumer production, and anti-fraud enforcement can create a healthy ecosystem. Requiring licensing merely reduces the ability for honest companies to operate, provide more opportunities for scammers.

Different people may have different views as to the outcome of different policies. However, under the laws of England, this debate can be avoided by merely stating the hypothetical possibility that the measures will lead to a positive social outcome. However, this is insufficient in Hong Kong because constitutional rights are involved. Suppose, after debate and argument, the executive and legislature conclude that licensing will merely cause scammers to move outside of Hong Kong. In that case, this legislation becomes unconstitutional as it restricts individual rights for no social benefit. Alternatively, it may be that after debate and argument, the executive and legislature determine that licensing will reduce consumer fraud. Under the "measure of appreciation" principle, when this debate occurs within either the executive or legislative process, the courts will defer to the administrative or legislative process results. However, this requires that such discussion has occurred, and we have seen no evidence that it has.

> Are there other mechanisms that would achieve the public interest goals of the proposed measures?

This question addresses the third step of the Hysan proportionality test. The proportionality test requires that the government undertake policies that impair rights as little as reasonably possible and raises the question of whether or not public interest goals can be met through other means. We believe that the proposed licensing framework fails this test. The justification for expanding licensing to VA OTC shops is confined to one paragraph (1.6), which states

> In 2023, a number of fraud cases associated with alleged VATPs have brought heightened public concerns over the risks of such VA activities. While the activities of VATPs fall under the regulatory remit of the relevant regime, the cases have unveiled the involvement of VA OTC shops. In particular, some VA OTC shops have served as one of the main avenues for channeling retail investors' funds to the suspected fraudulent schemes (e.g. by making false or misleading statements about having a VATP's status). Under such circumstances, the Government sees a need to bring VA OTC services within the statutory regulatory remit through legislative amendments, with a view to ensuring that the "same activity, same risks, same regulation" principle is observed and sufficient investor protection is provided for.

Under section 53ZRF of the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (AMLO), a person commits an offence if the person, directly or indirectly, in a transaction involving any virtual assets: (i) employs any device, scheme or artifice with intent to defraud or deceive, or (ii) engages in any act, practice or course of business that is fraudulent or deceptive, or would operate as a fraud or deception.

Under section 53ZRG of the AMLO, a person commits an offence if the person makes any fraudulent misrepresentation or reckless misrepresentation for the purpose of inducing another person to enter into, or offer to enter into, an agreement to acquire, dispose of, subscribe for or underwrite any virtual assets.

As we have illustrated, all of the VAOTC who have made false and misleading statements are subject to prosecution under Hong Kong law. The government has not explained why enforcement of these existing laws, which prohibit fraud are insufficient to protect the investor, and why a licence scheme is necessary

other than to involve the principle of "same activity, same risk, same regulation" which as we have argued is not a sufficient justification to limit individual rights. Moreover, if the existing laws are insufficient, the government has not explained why adding licensing will increase investor protections. We should note that people who commit fraud and make misleading statements regarding virtual assets are also likely to continue to operate without a licence or from off-shore. If the government does not have the resources to enforce existing anti-fraud legislation, adding new legislation is unlikely to be helpful.

We note that has been no effort to consider less intrusive measures other than instituting licensing. For example, AML/KYC requirements can be instituted by requiring any business that conducts VAOTC activities on an ongoing basis to keep records of their clients. Similarly, a mechanism of registration rather than licensing was also not considered. The fact that the government has not considered any less intrusive measures to combat fraud is troubling. We believe that courts may strike down these measures post-enactment unless the government provides additional justification for why licensing is necessary.

> Do the proposed measures achieve some public good that is proportionate to the limits of individual rights?

This question addresses the fourth step of the Hysan proportionality test. The proportionality test intends to avoid issues arising when focusing on one goal, which excludes consideration of others. The argument for licensing VAOTC is that by facilitating the conversion of fiat to virtual assets, the VAOTC service providers made scams such as JPEx easier. However, we believe the approach taken here is akin to restricting smartphone access because smartphones can be used for scams. Limiting or banning smartphones would indeed prevent people from being scammed. However, this action would have consequential activities that would make the cure worse than the disease.

The proposed licensing restrictions would severely restrict my ability to dispose of the stablecoins I have acquired from my research and development activities. Given the difficulties I have faced in obtaining banking services and the fact that I expect unfriendly foreign powers to be interested in limiting my research activities, I may be unable to convert my virtual assets to Hong Kong dollars. If this were to occur, others in my situation and I would like to have the option of starting a business to dispose of our virtual assets, and the proposed licensing scheme would limit our ability to do so.

For the government to justify the legislation, it would have to argue that the limitation on my freedoms is a proportionate response to some public good. There are indeed many people who should not be using virtual assets, but how is requiring a license for me to dispose of my own virtual assets the way I see fit, a proportionate response to this issue? I do not see any obvious answer to this question. Perhaps the government may be able to justify these restrictions, but they have thus far, not addressed this issue and must do so for the legislation to be constitutionally valid.

> How do the proposed measures influence other public needs and goals?

This question also addresses the fourth step of the Hysan proportionality test. This test is critical because it requires that decision-makers consider not merely the impact of the measure on the stated goal but the total impact of the measure on society. One difficulty in formulating virtual asset policy is that the Hong Kong government has been unclear as to which public policy goals it considers to be most important, how it chooses to deal with conflicting goals and how the proposed measures impact different goals.

We note here that in considering virtual asset regulation, the Hong Kong government typically cites one public policy objective to justify its measures, but acts in ways that seem inconsistent with those objectives. For example, in this case, we are told that the objective is to combat deceptive advertising, but if this is the case, then why is the Consumer Council not involved in the legislation, and why is licensing to be undertaken by amendments to the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap 615) rather than the Sale of Goods Ordinance (Cap 26) or the Trade Descriptions Ordinance (Cap 362).

Under the "proportionality principle" and "measure of difference" the executive and the legislature are required to consider the balance between competing public interests when constitutional rights are involved [16]. Because the proportionality principle requires a balancing between constitutional rights and public good, it is insufficient to cite merely one public policy rationale to justify a measure, but rather

[16] Fok Chun Wa & Anor v. Hospital Authority & Anor (2012) 15 HKCFAR 409

in considering public policy, one must holistically consider the total implications of these policies.

Similarly, we are concerned that the focus of the public consultation merely states the rationale for policy anti-money laundering, consumer protection, and international standardization and does not consider how these interact with other policy objectives, such as promoting innovation and national security. The consultation notes 200 VAOTC physical shops and 250 digital platforms. Each of these shops and platforms generates employment and economic growth at a time when Hong Kong needs new industries, and the consultation does not consider those factors will impact job creation.

Moreover, the public consultation focuses on administrative details and does not concern itself with overall virtual asset strategy and vision.

Given that these measures impact constitutional rights, this is unacceptable as the failure to consider public goods holistically makes it impossible to perform a proportionality analysis when constitutional rights are involved.

We are aware of and are sympathetic to the historical reasons why policy coordination is complex in Hong Kong. Under British administration, the Colonial Office in London made fundamental policy decisions, and the role of the local civil service was to implement decisions made elsewhere. The role of the Legislative Council under British rule was merely advisory and involved public input only after the Colonial Office and the local civil service had decided on policy. The judiciary's role was to enforce and interpret decisions made elsewhere, and the Hong Kong judiciary was and continues to be reluctant to involve itself in controversial public policy decisions.

The result of this is that the Hong Kong government is strong in policy implementation but weak in policy formation. In cases where there are clear stakeholders in a given policy, this weakness can be addresses through communications between a given department and the interest groups associated with an industry, and efforts at virtual asset regulation appears to focus on this model. However, we believe that this approach will fail because it fails to consider overriding policy concerns such as constitutional and national security issues, and also because virtual assets are an area where there are competing stakeholders.

The lack of policy coordination and integration becomes unacceptable when there is a need to balance public policy objectives with constitutional rights. Our solution to this dilemma is for the Hong Kong government to place the role of policy coordination on the capitalist market, and to intervene only in cases where it is clear that the market is unable to achieve a social good. We understand that others may disagree with this approach, but we wish to point out that although the question of how Hong Kong should coordinate different policy goals are open, avoiding this debate is impossible due to constitutional reasons.

> What limits are to be placed on the "blank cheque" authority that is proposed through licensing to avoid unconstitutional actions in the future?

This question arises from the impact of licensing on all four stages of the Hysan test due to the unique nature of licensing, which can constitute a "blank cheque" to impose future restrictions on constitutional rights. Other than a vague statement on investor protection and international standards, the FSTB has not explained the purpose and goals of licensing and how the criterion for licensing is rationally related to public policy goals. Furthermore, should we institute licensing and find unsatisfactory results, we see no way of reviewing the legislation and incorporating changes in the regulatory system.

There are severe national security issues with the proposed legislation

In addition to the constitutional issues, we would note serious national security issues, which we do not believe to be adequately addressed. We are alarmed at the statement in paragraph 2.1 of the public consultation request that there is an "emerging global consensus that VA regulations should address the potential money launder/terrorist financing risks posed to the international financial system". We are alarmed by this statement because much of this so-called global consensus consists of unfriendly foreign powers attempting to misuse the international financial system to create global rules that work against the interests of the People's Republic of China. And the so-called "criminal activity." that they wish to prevent includes Meng Wanzhou developing technology for Huawei and members of the Hong Kong government and judiciary who are enforcing the provisions of the National Security Law. Moreover, much of the activity in this so-called global consensus seeks to maintain a unipolar global system and prevent

the People's Republic of China from engaging in an independent foreign policy and being able to trade with whatever nations it believes to be in the Chinese national interest to trade with.

I am engaged in scientific and technological research for which I am paid in virtual currency from overseas sources. Because of my involvement with web3 activities, I find it difficult to obtain basic banking services and must rely on virtual asset OTC transactions to perform even simple functions such as paying my rent and buying groceries. I believe that many of the difficulties that I have are because of a campaign by unfriendly foreign powers to use banking law to limit the technological and economic development of the Chinese nation, and to prevent the People's Republic of China from conducting an independent foreign policy to create a multipolar world.

I am not alone in my banking difficulties. I note that the Chief Executive and many members of the Executive Council have had difficulties obtaining bank accounts, and that obtaining bank accounts has been difficult for many high-technology companies attempting to operate in Hong Kong. Although the Hong Kong regulators have attempted to address these issues, they have failed, and they have failed because precisely certain unfriendly foreign powers are actively using banking system rules to thwart the ability of the People's Republic of China to access capital and technology.

Virtual asset technology has resolved many of these issues and is an example of the success of the basic philosophy and constitutional foundation of Hong Kong Special Administrative Region to create a legal and constitutional framework by which the creativity of the capitalist system can be used to create original solutions to these problems for the benefit of the Chinese nation.

Indeed, the capitalist system of Hong Kong has created a network of virtual asset OTC providers that have enabled me to conduct my scientific and technological research and development activities. These OTC providers will be critical for the future development of technology in the People's Republic of China. In the past, companies such as Baidu, Alibaba, Tencent, and Huawei benefited by raising capital through international markets. These fundraising channels are now closed by unfriendly foreign powers, and for China to overcome these barriers, it must use financial technology to develop new ways of raising capital.

As with other issues, questions on how to deal with national security issues should be resolved through rule of law. We begin our analysis of the law with Section 2 of the recently enacted Safeguarding National Security Ordinance, which defines national security as

> the status in which the state's political regime, sovereignty, unity and territorial integrity, the welfare of the people, sustainable economic and social development, and other major interests of the state are relatively free from danger and internal or external threats, and the capability to maintain a sustained status of security.

Article 6 of the National Security Law makes it a responsibility of the Hong Kong government to safeguard national security.

> **Article 6** It is the common responsibility of all the people of China, including the people of Hong Kong, to safeguard the sovereignty, unification and territorial integrity of the People's Republic of China.

National security responsibilities are, by their nature, vague. However, we can see the national security objectives by examining the National Security Law. Specifically, we can see the law's objectives and national security goals by looking at what the law criminalizes.

Specifically, under Article 29, it is an offense to directly or indirectly receive instructions, control, funding, or other kinds of support from outside the mainland, Hong Kong, or Macao to commit the act of

> **Article 29(4)** imposing sanctions or blockade, or engaging in other hostile activities against the Hong Kong Special Administrative Region or the People's Republic of China

As with Articles 112, 115, and 118 of the Basic Law, we note that this provision is unique to Hong Kong, and interestingly, there are no similar provisions in the national security laws operating under the socialist system of mainland China [17]. The inclusion of this provision in the National Security Law illustrates the

[17] Part II, Chapter I, Articles 102 to 113 of the Criminal Law of the People's Republic of China revised to 26 December 2020

importance of the free flow of capital, goods and services in the capitalist system of Hong Kong, and how the preservation of these flows is vital to the national security of the People's Republic of China.

From the text of the National Security Law, one can see that one principal national security objective is to make the People's Republic of China more resistant to sanctions and blockades from foreign powers and to limit the ability of outside powers to conduct sanctions or blockade regimes. We believe, therefore, that virtual asset policy in Hong Kong should be structured to support this objective.

Concerning national security, many of the recommendations of international standard bodies toward virtual assets have been made with the explicit intention of some of its members to limit the technological growth of the People's Republic of China by limiting its ability to conduct cross-border trade and raise capital.

On 16 September 2022, the Biden Administration issued United States policy on digital assets with the Comprehensive Framework for Responsible Development of Digital Assets. According to this document [18]

> U.S. agencies will also continue and expand their leadership roles on digital assets work at international organizations and standard-setting bodies—such as the G7, G20, OECD, FSB, Financial Action Task Force (FATF), and the International Organization for Standardization.

Moreover, there has been much discussion in the United States about means of limiting the People's Republic of China's access to technology and capital [19].

These dangers are not merely theoretical. The difficulties that many high-technology companies and financial firms face in obtaining bank accounts in Hong Kong and the fact that banks in Hong Kong will enforce sanctions requirements by foreign powers against members of the Hong Kong government are due to certain foreign powers attempting to limit Chinese access to capital and technology. Furthermore, we should note the severe intelligence risks associated with anti-money laundering law as currently structured. Every time a high-tech company or financial firm reveals information to the bank to obtain banking services, they are revealing critical information that could be acquired by the intelligence services of unfriendly foreign powers who can then use this information to limit Chinese access to trade and technology.

We can see the vulnerability of the People's Republic of China to blockade and sanctions and the need to develop technologies and systems which enhance the ability of the People's Republic of China to resist efforts at "decoupling" or "derisking."

In addition, we note that the "same activity, same risks, same regulation" principle results in a "heads I win, tails you lose" situation for banking. Because the United States controls access to the US dollar, it can force Hong Kong to comply with US regulations to the point of having state-owned banks deny banking services to members of the Executive Council. By contrast, the United States will ignore any international mandates regarding its domestic law.

Given that certain foreign powers have undertaken a policy of limiting the access of the Chinese people to the technological, trade, and capital networks that are essential for the continued economic and development political development of the People's Republic of China, we consider it to be bizarre that Hong Kong would base its digital asset policy on international recommendations that, in many cases, have been specifically developed to be used in ways that are against the national interests of the People's Republic of China.

The capitalist system of Hong Kong has developed a virtual asset OTC infrastructure to circumvent banking restrictions that have been imposed on Hong Kong by certain foreign powers. We believe that these foreign powers are attempting to limit the use of digital assets by restricting "on-ramps" and "off-ramps" and by making it inconvenient and difficult for users of digital assets to convert these assets to and from fiat. We consider the development of an alternative payments ecosystem to be essential to the continued development of Hong Kong as an international financial center and for the People's Republic

[18] https://www.whitehouse.gov/briefing-room/statements-releases/2022/09/16/fact-sheet-white-house-releases-first-ever-comprehensive-framework-for-responsible-development-of-digital-assets/

[19] https://crsreports.congress.gov/product/pdf/IF/IF11803

of China to maintain access to capital and technology.

For Hong Kong to develop in this way, the private sector must have the maximum amount of freedom and minimal government interference in developing new technologies, and we believe that licensing will merely make it easier for foreign powers to maintain a chokehold on the Chinese financial system without providing any benefits.

We believe that the existing legislation is sufficient to deal with the national security risks of digital assets and OTC. Specifically under Articles 43(1) and 43(6) of the National Security Law, the Hong Kong Police are empowered to undertake electronic surveillance regarding digital assets. In conjunction with Article 43(7) which give the police the power to require a person to answer questions pursuant to a national security investigation and Article 43(3) which allows for the confiscation of assets used in conjunction with a national security offense. Moreover, Hong Kong entities are subject to the United Nations Sanctions Ordinance (Cap 537), and therefore, any use of virtual assets, which are against sanctions imposed by the community of nations are enforced in Hong Kong.

These provide more than adequate authority to prevent virtual assets from being used in ways against the national security interests of the People's Republic of China. However, virtual assets provide a payment mechanism that unfriendly third powers cannot easily block and that limits the information available to foreign intelligence services.

We believe that licensing of VA OTC providers will limit the growth of the virtual asset industry and prevent the capitalist system from developing new and original solutions to overcome the geopolitical challenges facing Hong Kong within the People's Republic of China. We are particularly concerned that the "same activity, same risk, same regulation" philosophy will force the virtual asset industry in Hong Kong to comply with the same rules as banks, allowing certain foreign powers to interfere with the foreign policy and technological and economic growth of the People's Republic of China. Moreover, requiring VA OTC to adopt the same anti-money laundering rules as banks will allow foreign intelligence services to more easily track the flow of capital to and from the People's Republic of China so that they can use this information to limit Chinese technology growth.

It is in the interests of Chinese national security to maximize the capital and virtual asset flows through the Hong Kong Special Administrative Region, where they can be monitored by the national security agencies of the People's Republic of China and where flows that are not in the interests of the People's Republic of China can be blocked. Moreover, by moving virtual asset capital through the VA OTC infrastructure, one limits the amount of information available to unfriendly foreign intelligence agencies. The proposed licensing scheme will encourage these flows to move to other jurisdictions where they will be less easily monitored and controlled by the national security agencies of the People's Republic of China and more easily monitored and controlled by the agencies of unfriendly foreign powers. We do not believe this to be wise public policy.

The requirements of national security and individual rights are often in tension as institutions attempt to balance the needs of society with the needs of the individual. However, in this particular situation, we note that *both* individual rights and the needs of national security calls for extreme skepticism toward the extension of licensing toward virtual asset OTC. This situation has legal ramifications. The fourth step of the Hysan proportionality analysis requires a balancing test between individual rights and the social benefits of the measure and, unlike the other three steps, requires the decision maker to consider *all* of the social consequences of the measures, not merely those which are the stated aim of the measure. If we believe that VAOTC licensing both infringes on individual rights and national security, then the measures would be unconstitutional under the fourth step of Hysan unless the government were to attempt to argue that investor protection and international standards compliance are more important than national security.

We believe much of the conflict between the legislative proposals and the national security needs of the People's Republic of China lies in the slowness of decision-making. We are asked to approve a legislative proposal based on the FATF's recommendation on 15 February 2019. FATF issued this recommendation before Meng Wanzhou was released, before the 2019 riots in Hong Kong, before COVID-19, before the National Security Law, before the Russo-Ukrainian War, and before the Isreali-Hamas War. Unlike the socialist system, where the state can quickly make radical changes, the capitalist system depends on a stable foundation of law that changes slowly and with much difficulty. However, because the changes in the law in a capitalist system are so slow, we believe that to respond to significant national security

changes, we should minimize the restrictions imposed by such laws and allow for maximum flexibility for the markets to adapt to ongoing changes, and based on this philosophy we believe that there should be no new regulation on VA OTC providers.

We would be interested in the views of law enforcement and the agencies responsible for protecting national security on this matter and look forward to their participation in this debate.

Q2. Do you agree that we should observe the "same activity, same risks, same regulation" principle in drawing up a new regulatory framework for VA OTC services, incorporating AML/CTF requirements in accordance with international standards while ensuring sufficient investor protection?

The principle of "same activity, same risks, same regulation" has no legal basis in Hong Kong law. Indeed, this principle *cannot* as a matter of law be applied to virtual asset regulation in Hong Kong Special Administration Region, as it is inconsistent with the constitutional framework and national security objectives of the People's Republic of China. We therefore believe that this principle must be abandoned, and virtual asset regulation in Hong Kong should be based on the principles of the Basic Law and the National Security Law within the "one country, two systems" policy framework.

The principle of "same activity, same risks, same regulation" has an immediate constitutional problem because it is simply not a legitimate aim that would justify any limitation of individual rights. Moreover, we do not believe that the courts would recognize mere compliance with external standards as a legitimate aim that would justify limiting rights guaranteed under the Basic Law. We note that the Basic Law exists to ensure that individual rights are protected from external influence under Chinese rule. We, therefore, do not believe that the courts in Hong Kong would recognize compliance with directives from FATF, IOSCO, or FSB or consistency with international standards to justify any infringement on individual rights any more than they would see compliance with a directive by the Communist Party of China or consistency with the socialist system of the mainland of China as justification for limiting constitutional rights in Hong Kong.

The one country, two system policy poses additional problems for the "same activity, same risks, same regulation" principle. The People's Republic of China practices the "one country, two systems" policies under which different parts of the People's Republic of China practice different social, political, and economic systems. In the mainland of China, the socialist system is practiced in which economic activities are conducted under the leadership of the Communist Party of China and in which access to foreign currency and virtual assets are heavily restricted.

By contrast, the Hong Kong Special Administrative Region practices the capitalist system where the Basic Law raises the free flow of capital and foreign exchange to a fundamental constitutional right. Therefore, the economic regulations of Hong Kong are and ***must*** be different from those of Shenzhen, Shanghai, and Beijing. The principle of "same activity, same risks, same regulation" would lead to the absurd and constitutionally impossible situation in which Hong Kong and the mainland have the same regulations regarding virtual assets.

However, just as it is constitutionally and legally impossible for the same regulations to apply in Hong Kong as in Shenzhen or in Shanghai, it is legally impossible for Hong Kong to copy the rules of London, New York City or Singapore. As we have illustrated in our response to Question 1, while Hong Kong and London share a historical legal foundation, Hong Kong cannot copy the laws of the United Kingdom or any other jurisdiction.

As we have noted in Question 1, in addition to the severe constitutional issues regarding the "same activity, same risks, same regulation" policy, there are similar issues concerning national security. Unfriendly foreign powers are using international standards bodies to promote an agenda of derisking and decoupling and of limiting access of the People's Republic of China to capital and technology. Rather than adopting similar regulations that will have the effect of making it easier for unfriendly foreign powers to adopt a regime of sanctions and blockade, the HKSAR should follow a policy of encouraging a parallel banking system that would make it more difficult for unfriendly foreign powers to deny the People's Republic of China access to capital and technology.

Again, we note that banks in the Hong Kong Special Administrative Region of the People's Republic of China must impose foreign sanctions against Hong Kong government officials and undertake AML/KYC

policies which have the effect of denying banking services to high-technology companies. The network of virtual asset OTC providers that now exists in Hong Kong allows for the Chinese nation to circumvent these restrictions, and we consider it bizarre and absurd that the Hong Kong government would seek to impose regulations whose goal is to limit the ability of the virtual asset industry in Hong Kong to circumvent technological and capital restrictions imposed by foreign powers.

We note that much of the stated rationale of the policy by the Financial Stability Board is to eliminate differences in regulation and thereby avoid regulatory arbitrage. However, this ignores that one of the purposes of the "one country, two systems" policy is to encourage *regulatory arbitrage* and encourage people from other jurisdictions, including mainland China, to conduct business in Hong Kong.

Financial regulators talk about "regulatory sandboxes". However, Hong Kong is the regulatory sandbox for the People's Republic of China and can and should be the regulatory sandbox for the entire world. The socialist system on the mainland of the People's Republic of China has been highly successful and should be maintained. However, the "one country, two systems" policy exists because there are activities that are in the interests of the People's Republic of China which may be difficult to perform within a socialist framework.

Moreover, the socialist system of the mainland of China, like the capitalist system of Hong Kong, can only survive if it adapts and grows, and Hong Kong has been the traditional testing ground for new policies which may be later adapted and incorporated within the socialist system.

As a result, the capitalist system of Hong Kong exists to encourage persons from the mainland of China and from elsewhere to operate in Hong Kong, where the Chinese nation can benefit from their talents, energies, and ideas, and where new ideas can be adapted and incorporated in the socialist system of the mainland of China at an appropriate time. To attract talent from the mainland of China and elsewhere, we believe that Hong Kong should follow a policy of "light touch" regulation and reduce and minimize the amount of regulation, and based on this philosophy, measures such as the proposed VA OTC licensing scheme are counterproductive.

> **Q3. Do you agree with the proposed scope and format of VA OTC services to be regulated and that operators of VA OTC services who provide temporary custody/escrow service as part of the transaction process should be brought within the regulatory remit?**

As we have mentioned, we are against creating licensing requirements. Although the stated intention is to regulate only spot trading of virtual assets "by way of business" and to allow P2P trading of virtual assets between individuals, the terms "by way of business", "P2P trading", and "individuals" do not have clear legal definitions. For example, if a day trader buys and sells virtual assets to make a profit, would this not be spot trading of virtual assets "by way of business"? If a trader uses virtual assets as payment for goods and services is this spot trading of virtual assets "by way of business." In my situation, I am paid in virtual assets for my programming services and as the price of virtual assets fluctuates, I may end up with a capital gain or loss depending on when I buy and sell, and it is unclear whether this would be subject to licensing under the definitions proposed.

We note that these difficulties arise because the proposed legislation seeks to impose restrictions of a type that has not existed before in Hong Kong law. Existing Hong Kong financial regulation exists to regulate financial intermediaries and the goal of financial regulation is to control the activities of intermediaries so that principals in the financial system can more efficiently and safely conduct business activities.

However, this proposed legislation seeks to limit the activities of principals and the limit what a person who owns his own virtual assets can do with those assets. This limitation has never been done before in Hong Kong law, and hence the difficulty in determining what is to be regulated and what is not to be regulated.

We note that people do not trade virtual assets for recreational purposes, and all real-world activities involving virtual assets involve some business activity. We also note that the difficulty of making a distinction between "individual p2p trading" and "spot trading by way of business" illustrates the inadequacy of using "same activity, same risk, same regulation" as a policy for detailing with virtual assets. Non-virtual assets typically require financial intermediaries to create liquid markets, but virtual assets allow for direct P2P trading. Once there is no clear distinction between a financial intermediary and a P2P trader, then

many of the assumptions that underline regulation fall apart and become legally incoherent.

Furthermore, we note that the notion of "investor protection" fails in this situation. In many business transactions, there is a clear "investor". However, this may not be the case for virtual assets. In my situation, I receive virtual assets as payment for goods and services, and I must convert those assets to Hong Kong dollars to pay for my daily expenses. I do not "invest" in USDT any more than I "invest" in Hong Kong dollar, and it is because USDT is unstable, and I require a network of VAOTC providers to immediately convert any USDT I have to Hong Kong dollars and convert Hong Kong dollars to USDT at the last possible moment.

Finally, we disagree with the assertion that this arrangement is consistent with the requirements stipulated by the FATF, and we would argue that the proposed regulatory licensing system runs *counter* to FATF regulations. In paragraph 37 of the Updated Guidance for a Risk-Based Approach Concerning Virtual Asset and Virtual Asset Service Providers issued the FATF notes that:

> The FATF defines peer-to-peer (P2P) transactions as VA transfers conducted without the use or involvement of a VASP or other obliged entity (e.g., VA transfers between two unhosted wallets whose users are acting on their own behalf). P2P transactions are not explicitly subject to AML/CFT controls under the FATF Standards. This is because the Standards generally place obligations on intermediaries rather than on individuals themselves (with some exceptions, such as requirements related to implementing targeted financial sanctions).

As virtual asset OTC businesses in Hong Kong typically trade on their own account and directly between the business wallet and the client wallet, it would be considered peer-to-peer transactions under FATF rules. This treatment is consistent with the fundamental technology of virtual assets. Virtual assets, by their very nature, have public transaction records, and the primary concern of FATF is that financial intermediaries may allow transactions to occur off-chain.

We note that the principle of "same activities, same risk, same regulation" is not a principle of FATF and has not been mentioned in any FATF circular we know. The principle of "same activities, same risk, same regulation" is an approach that has been championed by the International Organization of Securities Commission and the Financial Stability Board. Moreover, the concerns of IOSCO and FSB are aimed at financial stability rather than consumer protection.

We have noted a significant issue with virtual asset regulation in Hong Kong. In this case, the FSTB, which is an administrative rather than a political or judicial body, is attempting to implement rules based on policies and principles developed elsewhere. However, concerning the regulation of virtual assets, FSTB is forced to integrate conflicting standards and conflicting goals, and this is an inherently political or judicial activity for which a civil service agency is unable to adequately perform.

Moreover, attempting to base virtual asset regulation on these goals leads to incoherence. The proper approach and the approach that we believe to be required constitutionally begins by determining the public policy goals of virtual asset regulation and to then create policies that achieve these goals.

We would like to suggest that under the capitalist system of Hong Kong, it perhaps would be best to have these decisions be made by the markets and the private sector, and that the role of the government should be only to intervene when there is an apparent necessity for state involvement and it is our opinion that new licensing requirements are unnecessary at this time.

> **Q4. Do you agree that a licence applicant must have a local nexus and suitable premises/relevant local addresses for CCE's effective supervision and monitoring?**

We believe that these requirements should be issued as part of regulatory guidance issued by the license administrator (i.e., Customs and Excise), and should not be part of the legislation itself.

> **Q5. Do you agree that VA OTC licensees should only be allowed to provide VA-fiat (and vice versa) spot trading services, and subsequent remittance of exchange proceeds on specified conditions?**

We find the requirement that a company that uses virtual assets for the remittance of fiat money obtain two licenses to be absurd and redundant. Given that both the MSO and VAOTC licenses are to be

approved by the same regulator (Customs and Excise) and subject to the fit and proper same criterion, we see no purpose in requiring a separate license. The requirement for two licenses is particularly absurd given that Customs and Excise has already issued rules for the use of virtual assets for money services operators, and that the existing authority that Customs and Excise has over money service operators is identical to the authority to be given over VAOTC.

Although we are against licensing, we believe that should a VAOTC licensing system be necessary, that a person already licensed by Customs and Excise either as money services operators or as a dealer in precious metals and stones should be exempted from having to obtain an additional license for trading virtual asset activities in the course of their money services and precious metals and stones business, and that VAOTC regulation should be implemented as guidance through existing licensing regimes.

In addition, we see no rationale for restricting a license holder from engaging in other businesses. The standard financial rationale for preventing businesses from "tying" associated businesses is to prevent either monopolistic or anti-competitive practices or alternatively to avoid the ability of a company to use the proceeds from one business to finance another business in ways that increase financial risks. Neither rationale is present in the current situation.

Q6. Do you agree that VA OTC licensees should only be allowed to offer services in respect of VA available for retail trading on at least one SFC-licensed VATP and stablecoins issued by issuers licensed by the HKMA?

As we have expressed in our answer to Question 1, the creation of a licensing system creates "blank cheque" authority which should be viewed with skepticism. Even when the initial goals of the licensing system are constitutionally permissible; there is a danger that the licensing system can be used in the future for unconstitutional objectives.

Unfortunately, the strategy and objectives of licensing are blatantly unconstitutional under the Basic Law, and we assert that these provisions represent such a disproportionate limit on the rights listed in Basic Law Articles 112 and 115 that they are clearly unconstitutional. If these provisions are enacted either directly or through administrative action, we will seek judicial review to have them overturned.

First of all, we wish to point out that these restrictions would be strongly suspect as they are more than anything currently existing in Hong Kong under the Securities Futures Ordinance or the AML CFTO Ordinance. Although the SFO and AML/CFTO places restrictions on *how* a financial product can be traded and places licensing restrictions on intermediaries and facilitators such as brokers, in no case does the SFO of AML/CFTO place restrictions on *what* can be traded, nor does it place restrictions on the ability of a principal to dispose of property as they see fit.

In the case of the SFO, there are no restrictions on the ability of a principal to trade or sell any financial product directly to another willing buyer or seller who is acting as a principal. Similarly, while money services licenses places reporting requirements on money services operators, there are no restrictions on what currencies a money services operator can buy or sell. So, in contrast to all existing legislation that regulates *how* a product can be sold, this legislation regulates *what* can be sold.

The conflict between Article 112 and the proposed licensing system is not one of a minor legal technicality, but proposed restrictions which are intended to restrict the ability of the general public to use whichever forms of money are most conducive to their business requirements is the type of restriction that Article 112 was specifically intended to prohibit, and arises as the result of differences between the socialist system of the mainland of China and the capitalist system of Hong Kong.

Under the socialist system, strict controls exist over what can be used as money. The Renminbi is not freely convertible, and there are strict capital controls for the currency used in the mainland, and it is illegal under the socialist system to use anything other than renminbi for payment of goods and services [20]. Because currency is strictly controlled, there are very strong market and commercial pressures to use other forms of currency, and therefore the mainland of China has stringent laws that prevent any form of money other than the Renminbi from being used for transactions in the mainland of China. Because virtual assets can easily circumvent capital controls and make socialist economic management more complex, the controls on the use of money have been extended to virtual assets, and the exchange of

[20] Article 7 of the Regulations on Foreign Exchange Control

virtual assets and stablecoins is heavily restricted under the socialist system of the mainland of China.[21]

During the period leading up to the resumption of the exercise of sovereignty over Hong Kong by the People's Republic of China, there were concerns that the central government would impose capital controls, mandate the use of the Renminbi, and prohibit or limit the use of foreign currencies. These measures would have been highly damaging to the role of Hong Kong as an international financial center, and indeed harmful to the socialist system of mainland China. Because foreign exchange is very restricted under the socialist system, but the People's Republic of China needs trade and commerce with other nations, and the "one country, two systems" policy was instituted to allow a zone of capitalism to be the interface between the socialist system and other economies.

Therefore, Article 112 was enacted into the Basic Law to make foreign exchange and the free flow of capital a fundamental constitutional right. Under Article 112, persons engaged in economic transactions in Hong Kong have the freedom to decide what form of money they wish to use, and the Hong Kong government is forbidden from using state power to limit the ability of persons in Hong Kong to use whatever form of money they believe to be appropriate.

As a result, Article 112 is intended to prevent precisely the form of licensing and restrictions that have been proposed on the use of stablecoins. We are aware that the Hong Kong Monetary Authority is currently working on the development of e-HKD, and we wish the HKMA success in promoting e-HKD. However, whether a Hong Kong person chooses to use or not use e-HKD is a matter for the markets to decide, and the Hong Kong government does not have the legal or constitutional authority to force Hong Kong persons to use e-HKD over other stablecoins such as USDC or USDT, any more than they can force Hong Kong persons to use or not use Hong Kong Dollar or Renminbi in economic transactions in Hong Kong.

We believe that the presumed benefits of "investor protection" are nowhere near important enough to call for foreign exchange or capital controls as the ability to transact in whatever form of money a person sees fit is a cornerstone for Hong Kong's status as an international financial center. One should point out that one does not "invest" in cash or stablecoins, any more than one "invests" in Hong Kong dollar or US dollars.

Imagine that the Hong Kong government determined that the Turkish Lira, or the Egyptian Pound, or the Argentinian Peso were so volatile that retail traders should not be allowed to access these currencies. The negative impact on Hong Kong's status as an international financial center would be obvious, and we believe that the proposed licensing system on stablecoins would have equally disastrous effects.

Regarding other virtual assets, a requirement that a VA make available only coins that are available by one licensed VATP would violate Article 115 of the Basic Law. As with the restrictions on stablecoins, the Hong Kong government is seeking restrictions that currently do not exist under the Securities Futures Ordinance. The SFO places licensing restrictions on intermediaries. However, nowhere in the Securities Futures Ordinance nor any other provision of Hong Kong law are there restrictions on the ability of principals to trade financial products with each other.

Furthermore, delegating authority to commercial enterprises to determine which products can be traded is also constitutionally problematic. Under the principle of "measure of appreciation," the courts will defer to the judgment of administrative and legislative agencies, which may be better able to make public policy decisions. However, to argue for judicial deference, it is essential that the decision to restrict constitutional rights be made by the government. Delegating the decision as to what virtual assets can be traded to a commercial for-profit organization that is not subject to the constraints and restrictions of public institutions removes the judicial deference allowed under the "measure of appreciation" principle, as these organizations may have commercial for-profit and anti-competitive motives, which make it impossible for them to make decisions regarding the restriction of fundamental rights or the public interest.

A delegation of authority to make decisions regarding fundamental rights be made to a commercial, for-profit company not only violates the proportionality principle but also violates natural justice and the right to a fair hearing. When a public institution such as the Hong Kong Monetary Authority or the Securities Futures Commission makes decisions that impact individual rights, they are subject to notice and consultation requirements such as this consultation. Private for-profit enterprises are under no such restrictions and therefore are unsuited to make decisions that restrict individual rights.

[21] Notice on Further Preventing and Resolving the Risks of Virtual Currency Trading and Speculation 15 September 2021

Finally, allowing one set of commercial enterprises to determine what businesses other enterprises can undertake is simply bad public policy. Much of business law involves the creation of anti-monopoly and anti-trust regulations that exist to prevent one set of businesses from restricting what other businesses can undertake, and we find it odd that the government would suggest a business structure that runs in contradiction to modern business legislation.

Although we are prepared to overturn these restrictions through judicial means if they are enacted, we believe it is strongly in the interests of the Hong Kong Special Administrative Region if these provisions are removed during the drafting stage of legislation.

If these provisions are enacted and we are forced to seek judicial remedies to prevent their implementation, the Hong Kong government will be in the very uncomfortable position of having to argue that the constitutional guarantees against foreign exchange and capital controls or the guarantees that protect capital markets are limited. These positions will be reported in the world press, and we have no doubt that those who wish to see Hong Kong fail as an international financial center will use this dispute to smear the good name of Hong Kong.

However, if the provisions against using unlicensed stablecoin and unregistered securities are removed, one may ask whether they are such a core part of the strategy of licensing that we should debate whether licensing is worth introducing at all.

Q10. Do you agree with the exemption arrangement?

Given that virtual assets are commonly used for money services and in settlement for precious metals and stones, and given that these licensees are regulated by Customs & Excise, we believe that holders of money services licensees and precious metals and stones should be exempt from licensee when they conduct virtual asset spot trading services in the course of their business, and that regulation for these businesses should be done through regulatory guidance by Customs and Excise.

Q11. Do you agree that, for the purpose of protecting the investing public, persons without a VA OTC licence should not be allowed to actively market a regulated VA OTC service to the public of Hong Kong?

We believe that this limitation merely adds to regulatory confusion and will restrict the growth of the virtual asset industry in Hong Kong without providing any production to the consumer.

We note that there is no way, either legally or practically, that the Hong Kong authorities can prevent "passive marketing" or "reverse solicitation" of virtual asset services to the Hong Kong public from outside of Hong Kong. Furthermore, we refer to our response to Question 3 in that we have not seen a legally coherent distinction between personal P2P trading, whose restriction would certainly be constitutionally problematic, and virtual asset OTC trading.

Finally, we question the necessity of adding special legislation in this area. If a person advertises the provision of a service for which he is not able to legally provide, then certainly they would be subject to the civil and criminal liability under the Trade Descriptions Ordinance (Cap 362) or the virtual asset fraud provisions under the AMLO (Cap 615).

Conclusion

We believe the Chief Executive-in-Council should withhold consent to introduce new legislation on virtual asset OTC regulation until the constitutional and national security issues we have raised are resolved. The main justifications for the licence scheme are the "same activity, same risk, same regulation" principle and compliance with recommendations of international standard bodies, neither of which are legitimate aims that justify a limitation on constitutional rights. The government mentions anti-money laundering and investor protection, both of which are legitimate aims, but there has been no explanation given as to how licensing furthers either aim and no consideration of alternative measures that may achieve those goals with less impact on constitutional rights. There has also been no consideration of how this legislation would impact national security or other legitimate social aims, such as national security, employment promotion, or technology promotion.

We believe that the problems we have raised are unresolvable, and we hope that after review, the Chief Executive-in-Council agrees with our assessment and does not introduce any new legislation on this

matter. However, should the government decide to proceed with the legislation, the constitutional and national security issues that we have raised must be addressed at three different locations

1. as a government bill, any legislation will have to be introduced by the Chief Executive-in-council. Before any legislation regarding virtual asset OTC trading is introduced, it should be vetted by the Constitutional and Mainland Affairs Bureau and the Commission for Safeguarding National Security
2. the national security and constitutional issues raised should be debated by the Bills Committee of the Legislative Council. However, we believe that should the debate reach this stage, the Legislative Council should go beyond its traditional role of polishing legislation and that many of the fundamental principles of virtual asset regulation should be debated
3. any legislation that violates the principles of proportionality and margin of appreciation can be challenged through judicial review.

We believe that it is best if the issues that we have raised are addressed as early as possible, and preferably at the Executive Council stage. Although we fully intend to assert our constitutional rights through judicial review if necessary, we believe this is only a last resort, and we have raised the constitutional and national security issues in this public consultation so that they can be addressed early.

We have noted areas in which the law of other common law jurisdictions has influenced the law of Hong Kong. However, here is an example of how laws and processes from the mainland of China can influence the laws of Hong Kong. In the mainland of China, constitutional review is primarily a legislative process instituted before a law is enacted rather than a judicial process instituted after the law is enacted. Conducting constitutional review before a law is enacted has many benefits, as the difficulty and cost of addressing constitutional issues while a law is being drafted is much smaller than going through a judicial process after the law is passed. Also, focusing on constitutional issues while a law is considered increases democratic participation and emphasizes that the constitutional order is made of the people, by the people, and for the people rather than by the judicial experts.

We have noted earlier that we and other technology companies have had difficulties obtaining banking services. The ability of foreign powers to impose sanctions through Hong Kong banks is an issue that also personally affects the Chief Executive and other key members of the Executive Council. Because the approval of the Chief Executive-in-council is necessary for the government to introduce a bill to the Legislative Council, we hope that the fact that much of the Executive Council is unable to access banking services due to sanctions by unfriendly foreign powers will make them sympathetic to our arguments that any licensing of VA OTC and the approach of "same regulation, same risk, same activity" are not in the interests of Hong Kong, and that Hong Kong should for national security and constitutional reasons adopt a light-touch regulatory policy so that the creativity and energy of the capitalist system can create means to thwart efforts to deny the People's Republic of China access to capital and technology.

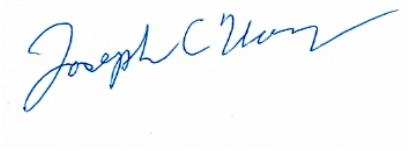
We understand that while we patriots are united in our love for Hong Kong and love for China, that different persons and different groups may have different views on the topic of financial regulation, and we look forward to a vigorous and healthy debate over Hong Kong's regulatory policy within the framework of the Basic Law.

As a young child, my father taught me about the struggles of George Washington at Valley Forge as he struggled to create a new nation or the difficulties that Dr. Sun Yat-Sen faced in founding a new Chinese republic. As a physicist, I have learned that the same ideas may be expressed in very different forms using very different names and believe that my father would be pleased to see how the ideas of popular sovereignty, nationalism, and the people's welfare are being expressed in modern China and how China has overcome the difficulties of the past. Whatever contradictions now exist among those who love the Chinese nation they are non-antagonistic and can be managed through open democratic debate.

I have stated my views on this matter and look forward to hearing different and contradictory voices in

a vigorous but civil debate on these issues in the months going forward.

Faithfully yours,



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