Bitquant Digital Services
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March 28, 2023

Securities and Futures Commission
54/F, One Island East, 18 Westlands Road, Quarry Bay, Hong Kong
VATP-consultation@sfc.hk

Fellow compatriots:

I am the sole proprietor of Bitquant Digital Services, a small company that does research and development of new virtual asset technology. We are responding to the request for public consulation dated 20 February 2023. We grant permission to release this letter and the attached documents with attribution to any interested parties.

We are a small company whose staff consists of my wife and myself with an assistant. I have a doctorate in astrophysics and several decades of programming and finance experience, including working in the quantitative research department of JPMorgan. Although born and educated in the United States, I returned to Hong Kong as part of the People's Republic of China to participate in the historic rejuvenation of the Chinese nation and to promote win-win economic, technological, and political cooperation between China and the United States.

Our company does not and does not intend to offer products and services to the general Hong Kong public. Nevertheless, as part of our research and development activities, we have set up a small private exchange requiring a license under the Anti-Money Laundering and Counter-Terrorist Finance Ordinance ("AMLCTFO"). Furthermore, as we have conducted these activities in Hong Kong before 1 June 2023, we intend to apply for a VASP license through an affiliated company and as well as apply for registered representative and responsible officer licenses for key personnel.

We have no objections to the proposed guidelines where they relate to AML/KYC activities. As we do not offer products and services to the general public, we have no opinions on providing digital assets to retail clients.

However, we are highly concerned over the proposed VATP Terms and Conditions and the VATP Guidelines, we, therefore, are filing this consultation to alert the SFC of the legal, constitutional, public policy issues in the consultation and to suggest solutions to these issues.

Question 8. Do you have any comments on how to enhance the other requirements in the VATP Terms and Conditions when they are incorporated into the VATP Guidelines?

In drafting our response, we are not only representing the commercial interests of our company, but also stating what we believe to be the interests of other small companies as well as companies that have yet to have been created and technologies that have not been invented.

We have created a small private virtual asset exchange for the purpose of allowing a small set of private investors to swap tokens corresponding to share of a limited partnership. A typical use case of our technology would be for a family office in which family member wish to exchange shares of a family trust among family members and close friends. Although our system will not be accessible to the general public, our system does contain an automated matching engine which will subject us to the definition of VATPs as stated in the public consultation document.

Our company is also heavily involved in "one belt, one road" activities involving using virtual assets to facilitate trade with North Africa, East Africa, the Middle East, and South Asia. In fact, it is our experience with what is known as the "license raj" that makes us aware of the destructive effects of overregulation and inappropriate licensing in other jurisdictions, and increases our patriotic commitment to perserve and advance the capitalist system as practiced in Hong Kong for the benefit of the Chinese nation.

We are also actively working with crypto-businesses in Austin, Texas, to establish win-win partnerships between Hong Kong and newly developing virtual asset businesses in the Silicon Hills area of central Texas. Our activities in promoting business and economic exchange between Texas and Hong Kong are intended not only for commercial benefit, but to increase trade and technology exchange for the joint economic and national security benefits of both the People's Republic of China and the United States of America.

Our views on the regulation of virtual assets are also influenced by the positive "light touch" policies of the state of Texas, versus negative policies carried out by the state of New York, specifically the negative effects of "BitLicense" of the New York State Department of Financial Regulation which we believe to have severely damaged the competitiveness of New York City as a center for virtual asset activity both within the United States and globally.

We also are have experience and business contacts in Singapore, Dubai, New York City, and London which we are developing in order to create win-win businesses models in the virtual asset space.

As a small technology company, we constantly experiment with new and original business models and technologies and require maximum regulatory flexibility to conduct experimental activities. However, our small-scale activities are unlikely to cause issues involving consumer protection, systemic risk, or anti-money laundering. Creating new innovative and unforeseen technologies is essential to the Hong Kong Special Administrative Region's continued economic prosperity and of vital interest to the continued economic growth and national security of the People's Republic of China.

We are, therefore, extremely concerned that SFC appears to be taking a "different risk, different activity, same regulation" approach by imposing the same sets of regulation based on existing business models without considering the likely implications for businesses with new and unforeseen business models, as well as making it difficult to experiment and develop new business models and technologies. Although traditional cryptocurrency exchanges can now be considered a mature technology, there are new and rapid developments in decentralized finance, blockchain, web3, and AI, and the proposed regulatory structure must be set up so that small businesses can explore and experiment with these technologies with the minimal regulation needed to protect public policy interests.

Unfortunately, the proposed guidelines contain a critical flaw that would cause significant problems for our company and companies similar to ours.

Specifically, the guidelines refer to virtual asset trading platforms ("'VATP"') while the legislation provides a legal definition for virtual asset service providers ("'VASP"'). The definition of what constitutes a virtual asset trading platform is not clearly legally defined in the legislation or any formal regulation or guideline. The definition of VATP is in footnote 3, and page 8 of the consultation document suggests that the SFC considers VATP's to be a subset of VASP's, while the definition of "platform operator" in page 4 of the proposed guidelines suggests that the guidelines are intended to apply to all license applicants.

Under the provisions of Section 53ZRD of the AMLCTF (Amendment) Ordinance 2022, an operator must obtain a license from the Securities and Futures Commission in order to carry on a VASP service business. There are no provisions in the legislation for exemptions and no exceptions to the rule.

If the definitions of VASP and VATP are different, then the lack of a provision for the SFC to license VASPs that do not constitute a VATP would amount to a de facto and perhaps unintended prohibition on such activities in the Hong Kong Special Administrative Regions.

If it is the case that all VASPs are covered under the guidelines for VATPs, then the proposed guidelines which are specifically intended for large established exchanges would amount to an effective prohibition on the activities of small technology companies such as ours. Having the same guidelines and regulations for all licensees would violate the "same risk, same activity, same regulation" principle by creating a situation of "different risk, different activity, same regulation."

In either event, the outcome would effectively amount to a prohibition on our activities in Hong Kong. We believe that this outcome where the regulatory frameworks would result in our company and companies similar to ours, being unable to conduct business in Hong Kong would be so inappropriate, unreasonable, and disproportionate as to be an impermissible restriction on the free flow of capital under Article 110, 112, and 115 of the Basic Law and would likely not survive judicial scrutiny under the standards issued by the Court of Final Appeals in the Hysan Development Co Ltd and Others v Town Planning Board (FACV 21/2015) (''the Hysan decision''). We have outlined our position on the constitutional framework of securities regulation in previous filing which we have currently attached.

In addition to the constitutional and legal issues raised by the proposed guidelines in the public consultation, there are also public policy issues. Under the "one country, two systems" policy, the Hong Kong Special Administration Region practices the capitalist system, which is different from the socialist system practiced in mainland China. This situation places responsibility on us patriots to boldly innovate and creatively develop the capitalist system for the national interests of the People's Republic of China.

Developing the capitalist system of Hong Kong requires that the Securities and Futures Commission sets guidelines in which state authorities intervene in the markets to the minimum amount necessary to advance public policy. In addition, the capitalist system in Hong Kong requires making Hong Kong an international financial center that is an attractive destination for any person, regardless of their level of patriotism, who is willing to willing to obey the laws of the Hong Kong Special Administrative Region.

Therefore Hong Kong regulations should make it easy and simple for companies to set up operations in both Hong Kong and other jurisdictions. The goal of Hong Kong policy should not be to poach companies and employees from other areas, but rather to allow a company to set up operations in many different jurisdictions to foster win-win trade with other regions.

As such, it makes no sense that the proposed guidelines create a system by which virtual asset service providers such as ours would be subject to more restrictions and state intervention than they would if they were operating in Singapore or Texas and would thereby discourage such companies from establishing themselves in Hong Kong.

We note that the operators of our exchange are from Austin, Texas and have done remote work from Singapore. Under Hong Kong law and the proposed licensing system, there is nothing that would prevent us from conducting business with clients in Hong Kong remotely from Singapore and Texas. Despite this, we intend to get a VASP license from Hong Kong not only so that we can create jobs and opportunities in Hong Kong, but also promote Hong Kong as a virtual asset hub and convince other small innovative SMEs in the digital asset space to set up operations in Hong Kong.

This is not a zero-sum situation, as having SMEs set up operations in Hong Kong will ultimately be of economic benefit to other virtual asset centers such as Singapore and Austin, Texas and vice versa. We wish for a regulatory system in Hong Kong that generates wealth by increasing economic interaction between all virtual asset centers. However, the proposed guidelines will not do this and will have the effect of limiting the local economic benefits of the virtual asset business in Hong Kong.

We note that the operation of a private exchange or swap system operating in the United States of America from Austin, Texas, does not require licensing or regulatory approval from state or federal authorities. In the United States, exchanges are primarily regulated as money service operators with licensing done at the state level. Because we are not involved in money services and do not offer services to the general public, our private exchange activities are, therefore not subject to licensing and regulation under United States Federal or Texas state law. Any issues that are present with the issues of security tokens can be dealt with via Regulation S and Regulation D exemptions, and ambiguities in the law can dealt with through a review of "no action" letters issued by either FINCEN or the Securities and Exchange Commission or a request for the issuance of such letters.

We note that within the United States the favorable regulatory climate of Texas and Florida, in contrast to that of New York state has caused an exodus of talent and resources from traditional financial centers such as New York City toward centers such as Miami and Austin. Specifcally the introduction of an additional layer of state regulation and licensing by the New York State Department of Financial Services in virtual currencies, commonly known as BitLicense, has severely weakened the role of New York City as a virtual asset hub in favor of Austin, Texas and Miami, Florida where no state-level licensing exists, and operators are only subject to Federal rules. We have observed that the BitLicense of New York states has served only to increase regulatory costs on small technology companies without any public policy benefit, and

we hope that the SFC learns from and avoids the mistakes of regulation in the state of New York.

Furthermore, we also note that our activities are not subject to licensing or regulation under the laws of the Republic of Singapore. Although we are establishing an exchange for virtual assets and digital tokens, the tokens which we intend to trade on our exchange are neither security tokens nor digital payment tokens and hence are activities are not regulated by the Monetary Authority of Singapore under either the Securities and Futures Act or the Payment Services Act.

Even in cases where we would be subject to regulation by Singapore, we note that the cost of such regulation, such as for example the capital requirements, is substantially lower in Singapore than what is being proposed for Hong Kong, and that the Monetary Authority of Singapore has issued numerous general licensing exemptions for specific business models, something which the SFC cannot do under the current legislation. We note that nothing in Hong Kong law would prevent a Singapore company from servicing clients from Hong Kong provided that they are not engaging in active marketing, a restriction which can be rendered irrelevant by global passive marketing.

Finally, the capitalist system of Hong Kong and Hong Kong's role as an international financial center provides a connection point between the socialist system of Mainland China with the global financial system. Because socialist system of Mainland China has unique and specific requirements, the virtual asset ecosystem within Mainland China will evolve with companies, practices, and business models which are unique, unusual, and unforeseen.

In order to allow Mainland companies to connect to global markets through Hong Kong, Hong Kong must have a flexible regulatory system that will accomodate the unique and unusual requirements of businesses originating out of Mainland China. We believe that "different risk, different activity, same regulation" approach envisoned by in the public consultation document will prove unsuitable for this effort, with the consequent negative impact toward the develop of Hong Kong as an international financial center and the healthy and stable development of virtual assets, blockchain, web3, and AI within the socialist system of Mainland China.

We are in an environment where new technologies bring new opportunities and new business models. For Hong Kong to succeed as a virtual asset hub, the Securities and Futures Commission must be prepared to take a regulatory approach that considers the wide variety of business models and new technology. By forcing all virtual asset service providers to comply with the same sets of regulations and guidelines, these guidelines would make Hong Kong uncompetitive as a virtual asset hub and an international financial center.

We note that all of the current exchanges started from small businesses, and we believe that it is not in the interests of Hong Kong to create a regulatory system that prevents small enterprises from creating the next generation of financial innovation. As the SFC should considering the regulatory needs of this generation of businesses, the SFC should not create a regulatory system that forces the next generation to set up business elsewhere, and by forcing all VASPs to undergo the same level of regulation, the current consultation proposal does so.

Proposed tiered licensing system

We have stated the problems with the regulatory framework proposed by the public consultation document. We note that the Securities and Futures Commission cannot ignore these issues. The current regulatory framework would amount to a de-facto prohibition of our activities. From a purely commercial point of view, our best course of action would be to exit the Hong Kong market and focus our business activities outside of Hong Kong. However, as patriots committed to the great rejuvenation of the Chinese nation and the Chinese dream, we would find this course of action unacceptable.

Therefore without future action by the Securities Future Commission, we would be forced to seek judicial relief so that we may continue to operate our business in Hong Kong, and this would result in unnecessary time, expense, and controversy. However, as fellow patriots, we believe that the unsatisfactory nature of the proposed guidelines is not intentional and that through dialogue and consultations, we can create a satisfactory system. Indeed, we believe the transitional framework of the AML/CFT ordinance was specifically intended to promote this dialogue.

We, therefore, propose a tiered licensing approach that is adapted from the virtual asset regulatory system used in Singapore. We note that unlike the laws of Singapore, which grant financial regulators the power

to exempt certain businesses from licensing, the SFC does not have the legal authority to exempt a company from VASP licensing, even when it is clear that restrictions on the activities of the business are not in the public interest and conflict with the Basic Law and the one country, two systems principle.

We also note that the Securities and Futures Commission does not have a "no action" mechanism similar to the "no action" letters in the United States Securities Exchange Commission or FINCEN, which allows the regulators in the US to exclude certain activities from licensing and exercise fine-grained control over public policy, nor does it have the authority to grant general licensing exemption as does the Monetary Authority of Singapore. Finally, we do not believe that it is conducive for the development of the capitalist system of Hong Kong to adopt socialist practices of regulation through selective enforcement to achieve policies objectives determined outside of state institutions.

Because the legislation does not grant the SFC the power to issue exemptions to licensing and because any changes to the scope of licensing would be impractical because they would require subsidiary legislation through the Financial Services and Treasury Bureau, we are proposing a framework by which businesses with limited public policy impact can be licensed under a "registration-only" system. We also suggest that the SFC adopt the Singaporean model of creating different licensing conditions for major and standard exchanges. We have outlined the details of our proposal in an attachment to this letter.

Conclusion

In closing, we would like to note that our interest in virtual asset regulation in Hong Kong is not purely commercial. We consider it to be our patriotic duty to assist in the development of the capitalist system of Hong Kong as part of the one country, two systems policy and to contribute to the great rejuvenation of the Chinese nation and the fulfillment of the Chinese dream. In drafting this letter, we seek to not only represent our company's commercial interests but to speak on behalf of companies that have yet to be founded and technologies that have yet to be discovered.

We believe that the "different risk, different activity, same regulation" approach proposed in the public consultation guidelines would have such adverse, unreasonable, and disproportionate effects on small technology startups such as ours that they would constitute a disproportionate infringement of Articles 110, 112, and 115 of the Basic Law, which guarantee the free flow of capital and would have strongly negative effects of the development of the capitalist system of Hong Kong within the "one country, two systems" framework of the People's Republic of China.

Although we are prepared to seek judicial relief to address our concerns, we hope this will prove unnecessary and this matter can be resolved administratively with the Securities and Futures Commission within the legal framework set out by the Court of Final Appeals in the Hysan decision.

As fellow patriots, I believe that the staff of the Securities Futures Commission is equally committed to the economic development and national security of the People's Republic of China. I believe that any adverse impacts of the proposed guidelines are unintentional an therefore any differences that we may have are the result of misunderstandings that can be resolved through friendly and open dialogue.

I would therefore request a meeting with the Securities Futures Commission and with InvestHK regarding these issues and are open to considering any proposals that the SFC may have to resolve the issues raised

in this letter.

Yours Faithfully,

Bitquant Digital Services

encl: Proposed tiered licensing system
Filing regarding constititutional framework
CV of Manager

Proposed tiered licensing system for virtual asset trading platforms

In order to avoid the "different risk, different activity, same regulation" issues with the current consultation proposal, we propose that the licensing system be divided into four tiers, which are modelled after the tiered approached found in the regulations of the Republic of Singapore.

- Securities token license - A holder of the license would be required for any virtual asset service provider seeking to enter the securities business and would be analogous to the platforms licensed in Singapore under the Securities and Futures Act.
- Major VATP license - This would correspond to the major digital payment token platform license in Singapore, which falls under the Payment Services Act. The guidelines which the SFC has proposed would be applicable to this set of licensees.
- Standard VATP license - This would correspond to the standard digital payment token platform license in Singapore under the Payment Services Act.
- Registration-only license - This category of licensee would correspond to the Singaporean categories of services, which is exempt from licensing under the Securities Futures Act and the Payment Services Act.

A major or standard VATP license would be required for any platform operator who offers services to the Hong Kong general public either directly or through institutions regulated either by the Securities Futures Commission or the Hong Kong Monetary Authority.

The rationale for a division between a major and standard VATP license in Hong Kong arises from the the same market forces that caused the regulators in Singapore to make such a distinction. There is a difference between large global exchanges by which either Singapore or Hong Kong are the headquarters for global operations and a smaller local exchange whose focus is to serve as an "on-ramp" or "off-ramp" for local clients to connect to the global financial network.

The regulators at the Monetary Authority of Singapore have recognized that to subject all virtual asset operators to the same standard would violate the "same risk, same activity, same regulation" principle by creating a situation of "different risk, different activity, different regulation" and would needlessly harm the development of local exchanges focused on local clients. We believe it would be appropriate for Hong Kong to make the same distinctions.

A registration-only license provide the same role as an exempt activity in Singapore. The Singaporean regulators have recognized that the diversity of virtual asset businesses means that many specific businesses simply do not need regulatory monitoring, and hence the Securities and Futures Act the Payment Services Act allow the Monetary Authority of Singapore to grant general exemptions to businesses to activities which the MAS considered it not in the public interest to license.

Hong Kong law does not grant the SFC the authority to issue exemptions and the inability of the SFC to exclude activities from licensing will likely make Hong Kong uncompetitive with Singapore in attracting businesses, particularly businesses with new and innovative models and technologies which are unforeseen by the current regulatory system.

Furthermore, where there is an ambiguity as to whether or not a business should be licensed from a public policy standpoint the inability of the SFC to issue a "yellow light" approval means that such businesses are unable to conduct any operations in Hong Kong while the regulatory framework is being set up.

This would be a specific problem for attracting technology based businesses from Mainland China who often have unique and unforeseen business models which Singapore can exempt from licensing but which Hong Kong can not.

A registration-only license would address these issue and create a class of businesses which are analogous to an exempt activity in Singapore. A registraion-only license would be available for a virtual asset service provider who:

- does not engage in an activity covered by the remaining three tiers of licensing, or
- demonstrates to the SFC that the licensing conditions required by the other license categories would be disproportionate to the public good achieved by said licensing

A registration-only licensee would not be allowed to offer services directly to the Hong Kong public or indirectly through a regulated entity, such as by way of example bank or brokerage firm or any other regulated entity, which is involved in virtual asset transactions with the general public.

By way of illustration, examples of businesses which would be eligible for a registration-only license would be:

- a business that wishes to establish some presence in Hong Kong but is not prepared to fully commit resources to establishing a business
- an exchange that offers services only to a small closed group such as members of a family office
- a shipping company that uses virtual asset tokens for the purpose of improving logistics or providing trade finance
- a business operating in Hong Kong that services only clients outside of Hong Kong
- a private equity fund or family office that creates an internal exchange for members to subscribe or redeem shares
- a business experimenting with new blockchain, AI, or web3 business models.

The scope is intentionally open ended so as any new business models or technologies would be quickly incorporated into the licensing system. Without such a licensing system, any business that is covered by the VASP rules but falls outside the scope of businesses intended by VATP would be forced to set up in another jurisdiction such as Singapore.

A registration/no-objection process is required as the AMLCFTO does not grant the SFC power to issue licensing exemptions in the way that the Monetary Authority of Singapore has the power to issue exemptions, and the process involved in obtaining a registration-only license is modeled after the process used in Hong Kong for licensing money lenders under the Money Lenders Ordinance.

An applicant for a registration-only license will get a license after thirty days, provided that the SFC issues a no-objection letter to the applicant. A holder of the registration-only license would be subject to AML/KYC requirements.

Regulatory benefits for the SFC

We note that a registration-only system would be of benefit to the SFC. The legislation makes the SFC responsible for licensing of all VASPs, and this makes it difficult for the SFC to focus its attention on intermediaries which may pose specific risks to the financial system of Hong Kong.

Furthermore, there is a chicken and egg problem, by which a business is able to begin operations without regulatory clarity but regulatory clarity is impossible without there being existing businesses. Allowing a business to being operations under a "light touch" registration-only license will allow decisions on the scope and intensity of licensing to be deferred.

We have noted that with new and innovative businesses, that the business model and operations fall into legal gray areas where it is unclear what rules would apply. A registration-only system would provide a yellow light system by which a business with new and unforeseen business models can proceed with caution under a "light touch" regulatory framework.

We note that the cost of regulation, such as for example the capital requirements, is substantially lower in Singapore than what is being proposed for Hong Kong, and that nothing in Hong Kong law would prevent a Singapore company from servicing clients from Hong Kong provided that they are not engaging in active marketing, a restriction which can be rendered irrelevant by global passive marketing.

Rationale for a tiered system

These four categories correspond to the licensing categories used in Singapore. Having a clear tiered system allows the flexibility of a principles-based approach while having the clarity of a rules-based approach.

In addition, by having categories that are analogous to those in Singapore, this system reduces the scope of regulatory arbitrage. Because neither Singapore nor Hong Kong can prevent unlicensed exchanges from the other side to serve clients on their respective jurisdictions, having a situation in which one class

of service providers can operate in the other jurisdiction in the absence of a public policy justification simply results in capital flight to the other.

The criterion of which activities belong to which category is a decision that can be made by looking at the circumstances in Hong Kong. As a general policy, we believe that consistent with a "small state, large market" philosophy, that the requirements for any activity should be no more stringent than the one found in Singapore. Hong Kong has traditionally had a reputation for having a "lighter touch" regulatory system than Singapore, and we believe that this traditional should continue.

As with Singapore, all licensee holders, including registration-only licensees would be subject to AML/KYC provisions. We believe that as the stated purpose of the SFC is consumer protection, and that in the securities space, the SFC can only regulate securities available for sale to the Hong Kong public, that the criterion for the standard VATP and major VATP licenses will be that the platform offers services to the Hong Kong public and actively markets to the Hong Kong public. Services provided through private placements should be subject to registration-only rules.

As with the SFO, services that are not available to the general Hong Kong public and consist only of private placement activities would be subject to "light touch" regulation. We note that the Monetary Authority of Singapore has issued regulations under the Payment Services Act which exempts most non-public facing activities from licensure, and that subjecting such services to high levels of regulation would simply cause such services to serve Hong Kong clients from Singapore.

In addition, the SFC should look carefully at capital and reporting requirements to ensure that these match Singapore. The capital requirement for a major payment institution license in Singapore is SGD 250,000 (approx 1.5 million HKD), and the capital requirements for a standard payment institution license is SGD 100,000 (approx 600,000 HKD). Both of these are substantially less than the proposed minimal capitalization requirements of 5 million HKD in Hong Kong.

Finally, we strongly urge the SFC and the Hong Kong government to quickly address the regulatory gap between Singapore and Hong Kong. The current regulatory schedule will require that any new virtual asset service providers after 1 June 2023 be subject to the new guidelines. Although the SFC has begun a public consultation requiring virtual asset trading platforms guidelines, the SFC has not yet clearly stated whether all VASPs are considered VATPs.

We believe that the guidelines in the current form make Hong Kong extremely uncompetitive to Singapore, and that it will be extremely difficult to convince most institutions to relocate or even have a substantial presence in Hong Kong.

The virtual asset strategy of the Hong Kong government appears to be to attract large whales to establish themselves in Hong Kong, and while this has had some success, and large whales cannot survive without small fishes and the current regulatory system forces most small fishes to swim to Singapore.

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Sai Ying Pun

February 15, 2023

Fellow compatriot:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The constitutional framework of financial regulation in Hong Kong

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

A small exchange exemption

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

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

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

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

Conclusion

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

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

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

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

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

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

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

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

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

Yours Faithfully,

Bitquant Digital Services

encl: CV of Manager