

March 31, 2023



Securities and Futures Commission
54/F, One Island East
18 Westlands Road, Quarry Bay
Hong Kong

Email: VATP-consultation@sfc.hk

Dear Sir or Madam,

Ripple Labs Inc. ("Ripple") welcomes the opportunity to comment on the Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators Licensed by the Securities and Futures Commission (the "Consultation") published by the Securities and Futures Commission (the "SFC") on February 20, 2023.¹

Ripple would like to thank the SFC for the in-depth and comprehensive analysis that has been undertaken in the Consultation. We appreciate having the opportunity to provide our comments, and respectfully request the SFC take them into consideration as it examines the policy direction and scope of intended regulation for the virtual asset² ecosystem in Hong Kong. We welcome the opportunity for further engagement with the SFC on this Consultation and any other related consultations as may be appropriate.

Ripple is also appreciative of the opportunity to comment on the Discussion Paper on Crypto-assets and Stablecoins (the "Discussion Paper") published by the Hong Kong Monetary Authority ("HKMA") on January 12, 2022.³ Ripple responded to the Discussion Paper ("Ripple HKMA Response") on March 31, 2022.⁴

¹ See <https://apps.sfc.hk/edistributionWeb/api/consultation/openFile?lang=EN&refNo=23CP1>, Consultation Paper on the Proposed Regulatory Requirements for Virtual Asset Trading Platform Operators Licensed by the Securities and Futures Commission.

² The terms digital asset, virtual currency, virtual asset, cryptocurrency, crypto asset and others are used interchangeably in the marketplace. For the purposes of this letter, Ripple adopts the terminology and related definitions used by the SFC in the Consultation.

³ See <https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2022/20220112e3a1.pdf>, Discussion Paper on Crypto-assets and Stablecoins.

⁴ See https://ripple.com/files/Ripple_HKMA_Cryptoasset%20and%20Stablecoins_Discussion%20Paper_January%202022_final.pdf, Ripple response to HKMA Discussion Paper.

1. Introduction

Using blockchain technology, Ripple allows financial institutions to process payments instantly, reliably, cost-effectively, and with end-to-end visibility anywhere in the world. RippleNet, our enterprise software solution which is powered by a standardized application programming interface (“API”) and built on the market-leading and open standard Interledger Protocol, enables financial institutions to facilitate faster and less costly cross-border payments, demonstrating that deep interoperability between commercial financial institutions can make payments truly efficient, particularly in eliminating the uncertainty and risk historically involved in moving money across borders using interbank messaging alone.

Some customers, in addition to deploying RippleNet, choose to leverage XRP - the virtual asset native to the XRP Ledger, a distributed ledger platform - as a bridge between fiat currencies, further reducing the friction and costs for commercial financial institutions to transact across multiple global markets.

We would like to highlight that XRP is independent of Ripple (although Ripple utilizes XRP and the XRP Ledger in its product offerings). The XRP Ledger is decentralized, open-source, and based on cryptography. While there are well over a hundred known use cases for XRP and the XRP Ledger, Ripple leverages XRP for use in its product suite because of XRP’s suitability for cross-border payments. Key characteristics of XRP include speed, scalability, energy efficiency, and cost - all of which helps reduce friction in the market for cross-border payments, thereby removing barriers to Hong Kong’s growth as a technology and finance centre.

2. General comments and policy considerations

We respectfully submit that any regulatory framework for virtual assets should encourage responsible innovation by service providers and intermediaries while also ensuring appropriate risk management. In doing so, the SFC will not only promote the strengthened operational resilience of the virtual asset ecosystem, but also transform the way virtual asset services are provided. This will ultimately benefit both industry and end-users, and encourage investment in new technologies and innovation.

We therefore believe it is imperative that the SFC take into account the following guiding principles as it develops a regulatory framework for virtual assets, or determines where virtual assets best fit into existing frameworks. Taken together, these principles will encourage the potential of blockchain and virtual asset technology, while also establishing important consumer and market protections that ensure global alignment and reduce the risk of regulatory arbitrage.

Principle 1 - Adopt a globally consistent taxonomy

It is important to note that the only definition of a virtual asset is contained within the Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill, 2022 (“AMLO Bill”).⁵ The AMLO Bill defines a virtual asset⁶ as:

- a cryptographically secured digital representation of value that is expressed as a unit of account or a store of economic value and either
 - functions (or is intended to function) as a medium of exchange accepted by the public as payment for goods or services, for the discharge of a debt, or for investment purposes; or
 - provides rights, eligibility, or access to vote on the management, administration, or governance of affairs in connections with, or to vote on any change of the terms of arrangements applicable to, any cryptographically secured digital representation of value; and
- can be transferred, stored, or traded electronically.

The AMLO Bill also excludes those digital representations of value that constitute a securities or a futures contract from the definition of a virtual asset.

While the AMLO Bill gives market participants some comfort as to whether a virtual asset is considered a security or not, Ripple respectfully submits such assets should not be solely defined relative to a specific technology (e.g., cryptography), but, for the purposes of regulation, should instead fall under a broader heading such as “digital assets”, and subsequently classified depending on the particular economic function and purpose they serve.

Such an approach is consistent with that taken by other jurisdictions like the United Kingdom (“UK”) and Singapore, which have issued classifications that do not depend on whether a business model uses distributed ledger technology or not, but rather on the inherent characteristics of a token and the rights that attach to it.

Therefore, we respectfully request that the SFC consider adopting a taxonomy for virtual assets consistent with global best practices to provide clarity as to the legal character of such assets in Hong Kong. Additionally, Ripple recommends that there be a clear distinction between payment tokens, utility tokens, and security tokens, as outlined below:

⁵ See <https://www.legco.gov.hk/yr2022/english/bills/b202206241.pdf>, Legislative Council of Hong Kong SAR Anti-Money Laundering and Counter-Terrorist Financing (Amendment) Bill, 2022.

⁶ See AMLO Bill, Section 53ZRA.

- *Payment or Exchange tokens*: to describe non-fiat native digital assets that are used as means of exchange and have no rights that may be enforced against any issuer;
- *Utility tokens*: to describe those digital assets that create access rights for availing service or a network, usually offered through a blockchain platform; and
- *Security tokens*: to describe tokens that create rights mirroring those associated with traditional securities like shares, debentures, security-based derivatives, and collective investment schemes.

Principle 2 - Implement a risk-sensitive regulatory framework

We are supportive of the SFC's approach of applying effective regulation, supervision, and oversight to virtual asset activities and markets in proportion to the financial stability and consumer protection risks they pose (or potentially pose), in line with the principle of "same activity, same risk, same regulation".⁷

However, we recommend that the regulatory framework should also align with the following principles to be truly risk-sensitive:

- The regulatory framework should be **technology-agnostic**, and should not explicitly or otherwise endorse any particular technology. In practical terms, this means that financial services using virtual assets as a solution should not be treated differently from financial services embedding legacy architectures, and there should be parity in the treatment of all technology;
- Given the dynamic nature of virtual assets, prescriptive regulation risks obsolescence. Prescriptive regulation could also have the unintended consequence of hindering innovation and unwittingly increasing financial stability risk through 'business-model herding'.⁸ Therefore, we recommend that the SFC consider a **principles-based** regulatory framework that is drafted in a way to steer market participants to specific regulatory and policy objectives while maximizing flexibility and breadth of application; and
- The regulatory framework should use a **risk-based** approach to identify virtual asset services that pose sufficient risk to warrant regulation. A simple, and obvious initial distinction in risk-profile should be between virtual asset

⁷ Described as "same business, same risks, same rules" in the Consultation.

⁸ That is, the implicit market bias towards certain business models due to the regulatory requirements attached to given financial activities rather than to the behaviour of the market and fundamentals. This can reduce financial stability by undermining actor diversity and hence overall resilience within a financial system.

intermediaries that provide services to consumers (“B2C”) and those, like Ripple, that only provide enterprise services to businesses (“B2B”).⁹

The recommended regulatory framework, as proposed above, should be forward-looking and flexible while providing regulatory certainty and consumer safeguards, and at the same time meet the policy goals of encouraging innovation and growth of virtual assets in Hong Kong.

Principle 3 - Foster innovation sandboxes

Innovation sandboxes for market participants to test new and innovative products, services and business models with end-users in a controlled environment while being subject to regulatory oversight have been set up in multiple jurisdictions. However, while some regulators have set up successful sandboxes, many regulators currently do not offer any opportunity for such experimentation. This could lead to a potential divergence between jurisdictions in their expertise of supporting the virtual asset sector with the likelihood of regulatory fragmentation, and potentially even regulatory arbitrage, arising.

In order to incentivise innovation and inform the development of clear and consistent regulatory frameworks for virtual assets, we believe innovation sandboxes should be encouraged in Hong Kong, at the very least for specific use cases such as cross-border payments.

For example, the Monetary Authority of Singapore has a FinTech Regulatory Sandbox¹⁰ which allows market participants to experiment with innovative solutions in a live environment, but within a well-defined space and duration. The SFC already has the SFC Regulatory Sandbox,¹¹ which could also be used for innovative solutions leveraging virtual assets.

However, it is important to note that innovation sandboxes will only be useful if there are clear entry and exit criteria defined, as well as parameters to measure the success of the sandbox.

⁹ Regulation has often drawn distinctions between B2B and B2C business models given the inherent differences between retail consumers and more sophisticated market actors. Examples include but are not limited to the European Union’s Second Payment Services Directive and Markets in Financial Instruments Directive.

¹⁰ See <https://www.mas.gov.sg/development/fintech/regulatory-sandbox>, Overview of Regulatory Sandbox.

¹¹ See <https://www.sfc.hk/en/Welcome-to-the-Fintech-Contact-Point/SFC-Regulatory-Sandbox>, SFC Regulatory Sandbox.

Principle 4 - Encourage public-private collaboration

Any policy framework intended to regulate virtual assets should promote an active dialogue between regulators and market participants. Such public-private collaboration will lead to more appropriate and effective policy outcomes for the industry and consumers alike. A collaborative forum that brings regulators and industry stakeholders together to build a rational and holistic framework for blockchain and virtual assets would represent a substantial step forward toward achieving regulatory clarity in Hong Kong.

We welcome the opportunity to provide feedback to the SFC on the Consultation, and recognise this is an important step towards public-private collaboration.

Principle 5 - Ensure global consistency and comparability

Lastly, given the cross-border nature of virtual asset markets, Ripple supports having minimum global standards, supported by cross-border cooperation and information sharing across jurisdictions, to help ensure an approach that is consistent and comparable.

However, Ripple posits that a framework that supports mutual recognition of licenses across jurisdictions could also lead to a level playing field globally, thereby supporting the sustainable growth and development of the virtual asset ecosystem.

Such mutual recognition decisions exist for traditional financial institutions and infrastructures, which can be used as a template for virtual asset service providers and intermediaries. Many of the regulatory and supervisory institutions for virtual asset companies would be the same as those for the traditional financial sector, which should foster trust and ease communication between jurisdictions. However, Ripple would like to highlight that in making such a determination, a principles-based approach should be followed (in line with Principle 2 noted above). An overly prescriptive process for a mutual recognition determination could disincentivize global firms from exploring this option.

With this overview, Ripple respectfully submits the following responses to the consultation questions set forth in the Consultation in the attached Appendix.

Ripple appreciates the opportunity to provide feedback on the Consultation as the SFC studies these important issues, and we would encourage and support further dialogue with all stakeholders.

Sincerely,

Ripple Labs Inc.

APPENDIX

Ripple respectfully submits the following responses to the questions set forth in the Consultation.¹²

Question 1: Do you agree that licensed platform operators should be allowed to provide their services to retail investors, subject to the robust investor protection measures proposed? Please explain your views.

Ripple respectfully agrees that licensed platform operators should be allowed to provide their services to retail investors, subject to robust investor protection measures. Doing so will allow for a vibrant virtual asset ecosystem to flourish in Hong Kong, and will balance the innovation that the sector brings with the need for customer protection.

As the SFC has noted in the Consultation, banning or otherwise restricting retail access to virtual assets may have the unforeseen impact of investor harm, as it may lead to retail investors trading on unregulated trading platforms overseas. The collapse of any such unregulated overseas platforms would leave investors with little recourse. Therefore, Ripple is supportive of the SFCs proposal to allow retail access to virtual assets, and would urge the SFC to ensure that any regulatory framework aligns with the principles outlined in Section 2 (General comments and policy considerations) of this response.

Question 2: Do you have any comments on the proposals regarding the general token admission criteria and specific token admission criteria?

Ripple is supportive of the general token admission criteria outlined by the SFC in the consultation.

However, Ripple respectfully submits that the specific token admission criteria is far too onerous and prescriptive for market participants to implement, and does not align with Principle 2 (Implement a risk-sensitive regulatory framework) as outlined in Section 2 (General comments and policy considerations) of this response. The specific token admission criteria proposed by the SFC will also be difficult to implement given the dynamic nature of virtual asset markets.

Instead, Ripple recommends that the SFC consider applicants that implement a holistic risk assessment of all the virtual assets the platform intends to support. This could include an assessment of the nature of the individual assets under the SFCs regulatory framework (i.e., if it is a payment token), as well as a supporting legal opinion on the same. Additional criteria covered could include a description of the characteristics and functions of the virtual asset at issue as well as assessment of whether the virtual asset has characteristics that promote anonymity, is known to be used by criminals for

¹² Unless otherwise defined, all terms in this section use the definitions provided in the Consultation.

illicit purposes, is susceptible to market manipulation and fraud based on its volatility and liquidity, and/or has been issued by reputable entities for lawful and legitimate purposes.

Such an approach is consistent with that of the Monetary Authority of Singapore ("MAS").¹³

Question 3: What other requirements do you think should be implemented from an investor protection perspective if the SFC is minded to allow retail access to licensed VA trading platforms?

Ripple is supportive of the other token due diligence requirements outlined in the Consultation.

Question 4: Do you have any comments on the proposal to allow a combination of third-party insurance and funds set aside by the licensed platform operator or a corporation within its same group of companies? Do you propose other options?

Ripple has no comments on this question.

Question 5: Do you have any suggestions as to how funds should be set aside by the licensed platform operators (for instance, under house account of the licensed platform operator or under an escrow arrangement)? Please explain in detail the proposed arrangement and how it may provide the same level of comfort as third-party insurance.

Ripple has no comments on this question.

Question 6: Do you have any suggestions for technical solutions which could effectively mitigate risks associated with the custody of client virtual assets, particularly in hot storage?

Ripple has no comments on this question.

Question 7: If licensed platform operators could provide trading services in VA derivatives, what type of business model would you propose to adopt? What type of VA derivatives would you propose to offer for trading? What types of investors would be targeted?

Ripple is supportive of the proposal to allow trading in virtual asset derivatives, and we welcome further consultation on this subject.

¹³ See

<https://www.mas.gov.sg/-/media/MAS/Sectors/Guidance/Guidelines-on-Licensing-for-Payment-Service-Providers.pdf>, Guidelines on Licensing for Payment Service Providers.

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?

Ripple has no comments on this question.

Question 9: Do you have any comments on the requirements for virtual asset transfers or any other requirements in Chapter 12 of the AML Guideline for LCs and SFC-licensed VASPs? Please explain your views.

Ripple is supportive of the requirements in Chapter 12 of the AML Guideline for LCs and SFC-licensed VASPs aligning with the related requirements set out by the Financial Action Task Force (“FATF”).

Question 10: Do you have any comments on the Disciplinary Fining Guidelines? Please explain your views.

Ripple has no comments on this question.