

Press Release

LCQ5: Regulating and facilitating financial technology development

Wednesday, December 6, 2017

Following is a question by the Hon Charles Mok and a reply by the Secretary for Financial Services and the Treasury, Mr James Lau, in the Legislative Council today (December 6):

Question:

Some members of the information technology sector have relayed to me that the existing finance-related legislation, which was drawn up with traditional financial activities as the blueprint, fails to dovetail with the current development of financial technology (Fintech). As a result, when start-up companies engage in Fintech businesses such as providing applications of blockchain encryption technologies or transaction platforms for cryptocurrencies, carrying out initial coin offering (ICO) and operating a virtual bank, they may easily and inadvertently fall into the grey areas and thereby breaching the law. In addition, some Fintech start-up companies have their bank accounts frozen or their applications for opening new accounts rejected by banks without explicit reasons, resulting in their daily operations being affected. They have also pointed out that Hong Kong is lagging behind places like Singapore and Japan in respect of regulating and facilitating Fintech development. In this connection, will the Government inform this Council:

(1) whether the authorities will, by making reference to the practices in Singapore, issue clear guidelines on the regulation of ICO to define unequivocally the respective legal liabilities of and requirements for the issuance platform, financial adviser and transaction platform of ICO, and to stipulate the details on how ICO is subject to the regulation of the securities laws of Hong Kong, in order to protect the rights and interests of those people engaged in ICO activities;

(2) whether the authorities will, by making reference to the practices in Japan, introduce a licensing system for cryptocurrency transaction platforms, and stipulate that the annual accounts of such transaction platforms must be audited by auditors, that such platforms must abide by anti-money laundering laws, and that the platforms must strengthen their "know-your-client" (KYC) process

which is for identifying and verifying clients' identities and is conducive to the prevention of money laundering, etc. so as to enhance the transparency of such transaction platforms and protect their clients; and

(3) as the Hong Kong Monetary Authority (HKMA) indicated in September this year that it would consult members of the banking sector on matters pertaining to the introduction of virtual banks, whether HKMA will consult local start-up companies and practitioners that engage in Fintech on the issue, and whether HKMA will, when introducing virtual banks, facilitate the participation of local and overseas innovation and technology enterprises, apart from allowing the subsidiaries of traditional banks and regulated financial institutions to engage in the provision of virtual banking services; if HKMA will, of the details; if not, the reasons for that?

Reply:

President,

In promoting financial technologies (Fintech), the Government strives to facilitate financial innovation on the one hand and to protect the investors on the other. The question touches upon a number of Fintech areas, namely initial coin offering (ICO), cryptocurrency and virtual banking. The Government has been keeping a close watch on the development of these areas in Hong Kong.

The question cited Singapore's regulatory approach towards ICO. We note that the recent statement and guidelines issued by the Monetary Authority of Singapore are similar in nature to the statement issued by the Hong Kong Securities and Futures Commission (SFC) on September 5 this year. They both remind market participants that depending on the facts and circumstances of an ICO, existing financial regulations could be applicable.

The SFC's statement points out that if digital tokens offered in an ICO are "shares", "debentures" or interests in a "collective investment scheme (CIS)", they would fall under the definition of "securities". In that case, dealing in or advising on the digital tokens, or managing or marketing a fund investing in such digital tokens, may constitute a "regulated activity". Singapore's regulation on ICO is similar to that of Hong Kong. If digital tokens are classified as capital market products, it would be subject to Singapore's

Securities and Futures Act.

The question also cited Japan's regulatory approach towards cryptocurrency exchanges, and not ICO. We note that the Japanese authorities acknowledge cryptocurrencies as a means of payment, and businesses which provide cryptocurrency exchange services are required to be registered. It is believed that Japan's regulatory approach should have taken into account the development of cryptocurrencies in Japan and may not be applicable to other markets. Markets like Hong Kong, the United Kingdom and Singapore do not have similar regulations. The Mainland of China and Russia even banned the operation of cryptocurrency exchanges within their jurisdictions.

In fact, depending on the development of individual markets, the regulatory approaches towards ICO and cryptocurrencies vary across jurisdictions. Some regulators impose a ban on ICO, while other regulators leverage on existing regimes to regulate such activities. We understand that the International Organization of Securities Commissions (IOSCO) discussed in depth the issue of ICO recently. IOSCO is highly concerned about the issue, encourages members to closely communicate with each other, and will closely monitor the future development.

For Hong Kong, we have repeatedly pointed out that digital tokens are not currencies but a type of virtual commodities. They do not have any backing whether in physical form or from the issuers. Such virtual commodities are highly volatile in price and do not qualify as a medium of payment or electronic currencies. The Hong Kong Monetary Authority (HKMA) has repeatedly reminded the public that virtual commodities are not regulated by the HKMA. Given their highly speculative nature, the HKMA has also repeatedly reminded the public to exercise extra caution. The SFC and the Investor Education Centre have also urged investors to be mindful of potential scams as well as the investment risks associated with ICO. As ICO operates online and may not have a physical presence in Hong Kong, investors may be exposed to heightened risks of fraud. We will further strengthen public education efforts to raise public awareness on the associated risks.

In addition, we note that the anonymous nature of virtual commodities poses potential money laundering or terrorist financing risks in their transactions. Financial regulators have required financial institutions to assess

carefully the money laundering and terrorist financing risks associated with virtual commodities and comply continuously with the statutory customer due diligence and record keeping requirements under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance when establishing or maintaining business relationships with customers who are operators of any schemes or businesses relating to virtual commodities.

We will continue to closely monitor the development of ICO and cryptocurrencies in Hong Kong, and maintain contacts with regulators in other jurisdictions through active participation in meetings of relevant international organisations, such as IOSCO.

For question (3) on the promotion of virtual banks, based on overseas experience, the HKMA considers that virtual banks without physical branches are commercially and technically viable. In September 2017, the HKMA announced a number of initiatives including the facilitation of the introduction of virtual banks so as to help prepare Hong Kong to move into a new era of smart banking. These measures have taken into account that virtual banks will facilitate the development of Fintech and enhance customer experience and financial inclusion. The relevant work has commenced and the HKMA has consulted both local technology firms and overseas institutions during the process.

According to the authorisation regime under the Banking Ordinance, a financial or technology firm may apply to become a bank to carry out virtual banking business so long as it fulfils the relevant authorisation criteria and prudential supervisory requirements.

Thank you, President.

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