

Speech
Speech by Acting SFST at SFC Regtech and Fintech Contact Day 2016
(English only) (with photo)
Monday, November 7, 2016

Following is the speech by the Acting Secretary for Financial Services and the Treasury, Mr James Lau, at the SFC Regtech and Fintech Contact Day 2016 today (November 7):

Ashley (Chief Executive Officer of the Securities and Futures Commission, Mr Ashley Alder), Bénédicte (Senior Director and Head of Risk & Strategy of the Securities and Futures Commission, Ms Bénédicte N Nolens), Doug (Professor in the Faculty of Law of the University of Hong Kong, Professor Douglas Arner), ladies and gentlemen,

A very good morning to everyone. And a special warm welcome to those coming from overseas to join our event today.

Fintech Week

I am delighted to join you all at the inaugural event of Hong Kong's first Fintech Week. There is a very rich programme this week, covering a good variety of activities, including pitching sessions, demos, workshops, etc. Apart from the Securities and Futures Commission (SFC), other organisations including the Hong Kong Monetary Authority (HKMA), Hong Kong Applied Science and Technology Research Institute (ASTRI), Cyberport and a number of private sector partners will be holding various events over the next few days to promote Hong Kong as a Fintech hub.

I am in particular pleased to note that Finovate is bringing its unique demo-only conference to PMQ tomorrow, after holding a round in New York in September and before it goes to London next February. Undoubtedly this is a very apt tribute to the New York, London and Hong Kong trio of the world's leading financial centres.

Let me share briefly with you a highlight of our Fintech developments in Hong Kong. I will then talk a bit about Regtech and Know Your Customer

(KYC). And I will round off with Fintech in wealth management and the role of Startups.

Fintech in Hong Kong

Hong Kong is an ideal place for Fintech development, as we are a leading international financial centre with a highly developed information and communication technology sector. According to the World Economic Forum's Global Competitiveness Report 2016-17, Hong Kong ranks second in the world, after Kuwait, in terms of cellular phone subscriptions. We are also the world's second in terms of Internet bandwidth coverage, after Luxembourg.

Hong Kong has a compact population of 7.3 million, with 6.5 per cent of its work force or about 240,000 persons working in its financial services sector. Our financial institutions, together with their financial professionals, have in-depth domain knowledge and they readily embrace technological advances in order to enhance operational efficiency and devise new products and services to meet evolving customer needs.

Another major reason many Fintech entrepreneurs have chosen Hong Kong is to gain first-class market access to the Mainland and the rest of Asia. For the Mainland, Hong Kong has preferential business access through the Closer Economic Partnership Arrangement (or CEPA). For the regional coverage, Hong Kong is well placed geographically and also has excellent business and market networks to serve as a business nexus for dealing with our regional partners.

To underscore Hong Kong's commitment to Fintech, our Financial Secretary announced in his 2016-17 Budget an array of measures to develop Hong Kong into a Fintech hub. Many of these measures have been implemented or are being put in place.

For the SFC, they have established a dedicated Fintech liaison platform called Fintech Contact Point to enhance communications with the Fintech industry. The HKMA and the Office of the Commissioner of Insurance have also set up similar liaison platforms.

These platforms are all tasked to handle enquiries and provide information on relevant regulatory requirements to companies engaging in financial innovation. This will enhance the industry's understanding of the regulatory environment in Hong Kong, and also help to ensure that an adequate balance is struck between market developments and investors' risk tolerance.

I understand that SFC's Fintech Contact Point has received the most regulatory enquiries among the three liaison platforms provided by our three regulators. This suggests a strong appetite for innovation in the securities and investment sector. Our colleagues at the SFC, under the leadership of Bénédicte, will continue to actively engage with the Fintech industry in relation to the intersection with SFC rules and regulations, so as to assist Fintech players to familiarise themselves with the regulatory landscape when they develop their business in our city.

If your interest is in banking, payment or insurance services, you are welcome to approach the Fintech liaison platforms set up by the HKMA and the Office of the Commissioner of Insurance, and share with them your vision and innovation projects. They are keen to facilitate the generation of novel ideas and the search for how best to take forward innovative solutions from financial institutions, startups, and other service providers.

And for our banks specifically, the HKMA launched its Supervisory Sandbox two months ago to provide greater flexibility to enable more timely live tests of Fintech and other technology initiatives. These pilot trials can involve a limited number of participating customers and can be conducted without the need to achieve full compliance with HKMA's usual regulatory and supervisory requirements during the trial period.

Two banks are already taking advantage of the Supervisory Sandbox to gather real-life data and user feedback on their new Fintech products or services under such a controlled environment. I am sure the Sandbox approach can stimulate more innovation and shorten the time to market for new Fintech products and services.

Blockchain, or distributed ledger technology, is another area where our regulators are studying in collaboration with the industry and research institutes. As part of Fintech Week, ASTRI will be releasing this Friday a white paper

commissioned by the HKMA on the initial research study and results on Blockchain. This paper is to provide the Fintech industry in Hong Kong with a reasonably comprehensive study of the key features, benefits, the potential and also risks associated with the technology. ASTRI has worked with many industry players in drawing up the white paper, demonstrating our public/private sector partnership in promoting Fintech development in Hong Kong.

And this project goes beyond just textbook-type narratives. It covers also the proof of concept for areas ranging from mortgage loan applications to trade finance. It will be a key step of our journey to gain a deeper understanding of the application of Blockchain technology.

In addition to the efforts made by our financial regulators, Invest Hong Kong, the government agency responsible for promoting inward foreign direct investment, has set up a dedicated Fintech team and co-ordinated the launch of this Fintech Week in Hong Kong.

The team will assist innovative Fintech enterprises, start-up entrepreneurs, innovation laboratories, accelerators, incubators and investors to establish in Hong Kong, helping them to tap the potential of expanding into the Mainland and Asian markets. Those coming from overseas and setting up in Hong Kong their Fintech undertakings can leverage on our sophisticated financial market environment, the presence of most major multinational financial institutions, the pool of knowledge workers as well as the legal environment and the protection of intellectual property rights.

The next major Fintech event to be organised by Invest Hong Kong will be the Fintech Finals 2017 to be held next January. This will showcase how Hong Kong's Fintech sector can provide your organisation fertile ground to develop Fintech applications and businesses.

And if you are joining the Fintech Innovation Lab Investor Day on Wednesday, do spare time to visit Cyberport's Smart-Space FinTech1, which is a dedicated Fintech co-working space. To accommodate the growth of the Fintech sector, this dedicated Fintech space will expand further to more than 3 000 square metres by the end of this year.

Regtech

Let me turn now to Regtech, a key focus of today's SFC workshop.

An article in the Economist published two weeks ago described Regtech as "Fintech's nerdy new offspring". Nerds are generally regarded as overly intellectual, obsessed with somewhat esoteric subjects and probably live in a world of their own. I suppose Regtech could be regarded as kind of nerdy when compared with Fintech, which is more well known for the likes of Bitcoin and crowdfunding platforms of various forms.

But today's nerdy Regtech may not need much time to gain word-of-mouth popularity. Take KYC for example. We all agree that client identity verification and authentication are essential for guarding against frauds, money laundering or financing of terrorism. But the question is how to do it in an efficient, intelligent and timely manner, especially when many clients nowadays wish to take advantage of the convenience provided by Fintech and other mobile channels, rather than relying on the traditional, face-to-face model.

A number of banks in Hong Kong have already rolled out or are about to introduce the use of biometrics, be it fingerprint, face or voice recognition, in client authentication for authorising transactions. And some speakers later this morning will provide their insight on using technology to strengthen and optimise KYC and client onboarding. So smart KYC will help not just the financial institutions but the consumers too, making it safer and more efficient to meet client onboarding requirements and conduct subsequent transactional operations.

In addition, just two weeks ago the SFC issued an advisory circular to provide more guidance on the regulatory requirements on client identity verification in the account opening process. In particular, the SFC considers the use of services provided by certification authorities outside Hong Kong as a practical means to facilitate cross-border account opening, provided that such authorities are recognised under our Electronic Transactions Ordinance. The circular of the SFC also notes the potential use of biometrics and Regtech to further decrease fraud risk. Such cross-border facilitation will help to

encourage the two-way flow of funds and investments and make them more secure too.

Advances in Artificial Intelligence (AI) have enabled Regtech to go beyond data collection, tabulation and basic analytics. AI can help to manage unstructured data and strengthen surveillance and risk detection. For instance, AI can analyse not only text messages but also social media footprints, including voice messages, and look for trading patterns and possible breaches of trading rules. AI can do the parsing of myriads of regulatory rules and guidance notes from different jurisdictions, and relate them to reporting, surveillance and enforcement mechanisms.

Against this light, we can see how the SFC has in a very timely manner embarked on a risk data strategy and analytics project to examine how risk data analytics can complement the SFC's daily work and existing processes. The goal for the SFC is a smarter use of data, data analytics, media analytics and risk dashboards. The goal is enabling quicker identification and response to the build-up of potential risks in the market. And the ultimate goal is market quality and sustainability of our financial services industry.

No discussion of Regtech would be complete without mentioning the application of Blockchain technology. As part of this pervasive development, there are already exciting advances in the context of Blockchain's individual ID. The concept consists of creating a record of identity on a Blockchain that includes not only traditional identity information such as an address, copy of ID documents and phone numbers, but also biometric records as well as records acknowledged or verified by third parties like universities, government authorities, employers and financial institutions. This concept allows third-party authorities as well as peers to validate the user's information, creating both a rich social fabric as well as powering solid KYC and anti-money laundering systems in the financial sector.

We welcome the industry to come up with creative and reliable application of electronic signature certificates for KYC procedures for client identity verification and execution of client agreements. And I am sure our regulators' liaison platforms will look forward to working with you and providing guidance on your propositions.

If I am allowed to look ahead a bit, apart from the personal KYC as outlined just now, perhaps in time financial services consumers can each carry a Risk ID too, indicating his risk profile and appetite, drawing from the financial product KYC and suitability assessment that he has gone through. Such Risk ID, if materialised, can facilitate purchase of financial services across institutions and perhaps across borders too. Today, a Risk ID may seem far-fetched. But with the development of increasingly sophisticated online financial services providers, covering not just online purchases or payment settlements, but also wealth management and other financial services, the current transactional model, which is based on financial institutions selling financial products, may in time change to one where consumers are agile purchasers shopping for financial products or services. In such an eventuality, a Risk ID may be a natural development flowing from the change in the transactional model.

Fintech in Wealth Management

In short, Fintech can be a likely disruptive game changer for investment and wealth management services.

With the vast growth of the sharing economy, massive data are captured by a new class of service providers. Big data analytics can study huge data sets to reveal untapped trends, patterns and correlations for forming trading ideas, credit scoring, and even predictions on the financial markets for fund managers to refine the execution of their investment strategies.

And robo-advisors, which provide automated, algorithm-based portfolio management advice with minimal human intervention, would become much more commonplace than today.

In light of such developments, we recognise that establishing an exchange distribution platform for funds in Hong Kong could bring potential benefits, such as opening up a new fund distribution channel for the asset management industry and broadening investors' choices. The Government has discussed with the Hong Kong Exchanges and Clearing Limited (HKEX) the possibility of establishing an exchange distribution platform for funds. The HKEX plans to cater for such a platform within its blueprint for its new

post-trade processing system, which will include capabilities that would support its clearing house participants in mutual fund-related trade and position handling.

Opportunities for Start-ups

Finally, let me touch briefly on Start-ups. Under the rapid IT development, we have a hyper-connective world augmented by cloud computing and cloud storage, with consumers having ready access to all sorts of smart phones and hand-held or wearable devices. The more open market ecosystem has lowered the market entry threshold for startups and non-traditional market participants. As I mentioned earlier, these new players have the potential to disrupt the conventional modalities, and unavoidably impact on existing market players.

So, Fintech presents both opportunities and challenges to the broader financial services industry. This is why many existing financial institutions invest heavily to search for the right Fintech applications to improve their existing repertoire and also develop new products to serve the new, mobile world. Start-ups become a ready source of inspiration and applications, and many of them work with existing financial institutions to develop such in-house solutions.

In Hong Kong, start-ups are helped by a number of accelerator programmes and innovation laboratories, which are organised by various local and multinational professional services firms, innovation organisations and also some of the incumbent financial institutions. And your active participation as mentors and collaborators of the startups will help expedite the growth for these budding enterprises, as well as making the Fintech sector in Hong Kong more vibrant. I would call this a Triple Win proposition.

And if your company wants to locate or start accelerator programmes or innovation laboratories in Hong Kong, our Invest Hong Kong Fintech team is right here to serve you.

Conclusion

Ladies and gentlemen, Fintech is on the verge of changing the world. And I guess the impact is much greater and over a much shorter timeline than what computerisation brought about half a century ago. So like it or not, we have to usher in the changes and we need to be prepared. This is why we are glad you are here for the SFC forum and various exciting Fintech events this week. And wherever you come from, I wish you a fruitful Fintech and Regtech journey in Hong Kong.

Thank you very much.

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