

Speech

Speech by SFST at ASIFMA Annual Conference 2017 (English only)

Thursday, November 30, 2017

Following is the speech by the Secretary for Financial Services and the Treasury, Mr James Lau, at the Asia Securities Industry and Financial Markets Association (ASIFMA) Annual Conference 2017 today (November 30):

Mark (Chief Executive Officer of ASIFMA, Mr Mark Austen), distinguished guests, ladies and gentlemen,

Good morning. I am very delighted to be here with you today at this annual conference of the ASIFMA. A very warm welcome to regulators, policymakers, market representatives and of course all those who come from overseas. This two-day Conference has a very rich agenda, covering issues concerning market development, regulatory challenges, policy issues and technology topics too. I see that the Conference covers the ABCDs of Fintech - artificial intelligence, big data, cybersecurity, and distributed ledger technology, or blockchain as it is commonly known. This morning I'd like to visit with you the tectonic shifts brought about by Fintech for the financial industry, with a focus in our part of the world. And I would also like to share with you developments here in Hong Kong that can shape Hong Kong as a Fintech hub.

First, let us put Fintech in the context of the digital revolution that we have witnessed today. This digital revolution is also known as the Fourth Industrial Revolution and the origin of this term is generally associated with Klaus Schwab, Founder and Executive Chairman of the World Economic Forum. If we go back to history briefly, the First Industrial Revolution saw the invention of the steam engine, notably by James Watt in the 1770s. This led to the mechanisation of many production processes.

Fifty years later, in the 1820s, there was the development of the electric motor by James Faraday. This led to further automation and mass production of manufactured products. This was described as the Second Industrial Revolution, although personally I would see the first two revolutions as somewhat overlapping and indeed, in classical articles, they are generally described as THE Industrial Revolution without demarcation by the source of power, i.e. steam and electricity. This industrial revolution was a major step forward and

affected history in the following century, helping many nations to harness their industries and built empires across the world.

In the 1960s and 1970s a major wave of change came with modern day information technology and data processing, brought about by advances in electronics and integrated circuits. The development of computers made it possible for humans to process data at a much faster rate and in a much more accurate manner. The vast speed of data processing has brought about electronic automation and increased efficiency in hardware production and software development, which resulted in extensive globalisation of the world economy.

And now, during the Fourth Industrial Revolution, we are seeing a digital revolution with the widest scope, highest velocity, and the most far-reaching impact so far, disrupting every sector and industry including financial services. And this is going to reshape the economy and future employment opportunities and career choices. Today, in this Industrial Revolution 4.0, we are experiencing changes brought about by the development of Internet communication and the miniaturisation of computers into mobile smart devices and phones. The world is increasingly connected, and there has been talk of technology bringing about a more level playing field and a more equitable distribution of wealth.

Now let me turn to China as a very apt, illustrative example of the transformational impact of Industrial Revolution 4.0 - not least because China has leapfrogged into one of the most vibrant and happening places for Fintech in the world.

Asia-Pacific investments in Fintech grew from US\$5.2 billion in 2015 to US\$11.2 billion in 2016, surpassing that of North America for the first time. Just for the record, North America attracted US\$9.2 billion in Fintech financing in 2016, and Europe US\$2.4 billion. In addition, all of the 10 largest Fintech investments in Asia-Pacific last year were in Mainland China and Hong Kong, accounting for 82 per cent of all Asia-Pacific Fintech investments.

What's more, based on the 22 000 online interviews for the Ernst & Young FinTech Adoption Index 2017, China came out first for Fintech adoption out of 20 markets around the world. According to the survey, 69 per cent of

China's digitally active population are regular Fintech users, compared to 42 per cent in the United Kingdom, 33 per cent in the United States (US), 32 per cent in Hong Kong and 23 per cent in Singapore.

The rise of China's Fintech sector is attributable to several factors. The ongoing economic reforms since 1979 and the gradual and steady opening of the financial markets and the economy have provided a supportive environment for the promotion of Fintech by market players. China's huge population provides a mass market for online and mobile financial products and services developed by tech companies, traditional financial institutions and non-financial companies that are making a push into Fintech. The demand for Fintech came also from the need associated with financial inclusion, where a large segment of the population in China has historically been underserved by the traditional financial services sector. All of the above have resulted in high Internet and mobile usage and a sophisticated sharing economy in China, truly allowing Fintech to flourish and mushroom.

China's Fintech story can be said to have started with e-commerce. As an example, Alibaba has evolved from an e-commerce platform to a player in the payments, financing and wealth management space. While Alipay was first launched under Alibaba's e-commerce platform in 2004, it was developed into a mobile app in 2009 and is used today by 520 million users for payments in all aspects of daily life, ranging from transportation, travel, supermarkets, restaurant reservation and payments to entertainment and utilities. WeChat Pay was first released in 2011 and now has 600 million active users. Alipay payments in 2016 was around US\$1.7 trillion, and WeChat was US\$1.2 trillion.

Similarly, Alibaba's Yu'e Bao, which literally means a leftover treasure, was initially a money market fund set up as a repository for just mere leftover cash from online spending. Today it has overtaken JP Morgan's US government money market fund by more than US\$15 billion to become the biggest in the world, with some 370 million account holders and US\$165 billion of assets under management.

Indeed, WealthTech has gained much traction on the Mainland. Compared with wealth management products offered by traditional banks, their Internet counterparts have higher returns, almost no entry barrier, and T+0 liquidity, explaining the high penetration of such products among Internet and

mobile users.

Robo-advisers are also expected to become more prevalent on the Mainland. Robo-advisers provide largely automated portfolio management advice, strategies and services for individual investors, who complete a profile pro forma that determines their risk appetite and investment objectives. Although still in its infancy, assets under management of robo-advisors in China are expected to increase to RMB6 trillion (US\$905 billion) by 2020. This is, according to estimates from China Merchants Securities, underscoring the potential for growth in an industry that was virtually non-existent until recently. There are many regulatory issues arising from such Fintech developments, but I am afraid I don't have time to address this aspect today.

Now let me turn to Hong Kong briefly. Unlike Mainland China, Hong Kong is a mature economy with a small market and a highly banked population served by a vast array of financial institutions and experienced professionals. Hong Kong's strengths as a Fintech hub lie in its established role as an international financial centre and a digitally advanced city. Indeed, Hong Kong is an ideal place for Fintech development as it has a highly developed information and communication technology sector.

According to the World Bank, Hong Kong had 234 mobile cellular subscriptions per 100 people in 2016, ranking second in the world just behind our neighbor Macau. We are also currently fourth in the world in terms of average Internet speed, with an average of 21.9 megabits per second, just behind South Korea, Norway and Sweden.

Let me share now with you Fintech developments in Hong Kong and how we can serve your community. In recent years, the Hong Kong Government and regulators have spearheaded efforts to develop Hong Kong into a Fintech hub. The Hong Kong Monetary Authority (HKMA) published its second white paper on distributed ledger technology (DLT) in October 2017, confirming the promising nature of DLT while acknowledging that DLT cannot be a universal solution for all financial applications, especially since legal and compliance issues may arise. The HKMA has plans to turn the findings and advice in the second white paper into a set of practical guidelines for the use of DLT in the banking sector.

Concurrently, seven banks in Hong Kong have decided to commercialise an HKMA-led, DLT-based, trade finance proof-of-concept into a production system named Hong Kong Trade Finance Platform (HKTFP) to digitise and share trade documents, automate processes and reduce risks and fraud. Actually, just last year when I was at a blockchain conference, some speakers said there was no way you could do DLT for trade finance as it was too complicated, cross-jurisdiction and so forth. But then it has changed by now. The HKMA is in discussion with the Monetary Authority of Singapore to build a cross-border infrastructure to connect HKTFP with a similar trade platform in Singapore.

On the regulatory front, the HKMA, the Hong Kong Securities and Futures Commission (SFC) and the Insurance Authority (IA) have all launched sandboxes to facilitate the development of Fintech in Hong Kong.

The HKMA was the first among the three regulators to launch its Fintech Supervisory Sandbox. Introduced in September last year, the sandbox allows banks to conduct pilot trials of their Fintech initiatives without the need to achieve full compliance with HKMA's usual supervisory requirements during the trial period. Over 20 cases of pilot trials of Fintech products involving nine banks have made use of the sandbox.

Just this week, the HKMA launched the Fintech Supervisory Chatroom as an enhancement to their sandbox. It seeks to provide supervisory feedback at an early stage when new technology applications are being contemplated, thereby reducing abortive work and expediting the rollout of new technology applications. If firms access the chatroom via email, the HKMA will endeavour to provide supervisory feedback within seven working days. Firms may also request for a video conference or face-to-face meeting.

On the securities front, the SFC Regulatory Sandbox provides a confined regulatory environment for qualified firms to conduct regulated activities utilising Fintech. For the insurance sector, under the auspices of our Insurance Authority, the Insurtech Sandbox facilitates pilot runs of innovative Insurtech applications by authorised insurers for application in their business operations. In addition, the Insurance Authority has also launched a pilot scheme called Fast Track to expedite applications to carry on insurance business in or from Hong Kong using solely digital distribution channels.

In terms of funding, we have the Enterprise Support Scheme, launched in 2015 by our government. It provides funding support to investment on innovation and technology projects undertaken by companies of all sizes. The Government also launched the \$2 billion Innovation and Technology Venture Fund in September this year to encourage co-investment from venture capital funds into early stage local start-ups from the Fintech and other technology sectors.

In addition, as an IT business park, Cyberport, which is a government initiative, is a key component of the Fintech ecology in Hong Kong. Cyberport currently provides designated support for a Fintech community of more than 30 nationalities in over 200 start-ups and companies. Cyberport is also home to the Accenture FinTech Innovation Lab, which is one of the many innovation laboratories and accelerators in Hong Kong set up by local and international financial institutions and professional service organisations.

Last but not least, as home to one of the most vibrant equity markets in the world, Hong Kong is in a unique position to attract Fintech companies to raise capital on our stock market. Just this September, Hong Kong saw the US\$1.5 billion Initial Public Offering (IPO) of ZhongAn Insurance, China's first Internet-only insurer, which was oversubscribed nearly 400 times from retail investors. Of course, we are acutely aware that Hong Kong will need to compete with other major financial centres in attracting Fintech listings. Hong Kong's stock market ranked the world's first in terms of IPOs in both 2015 and 2016. Our Main Board is currently ranked the world's 12th largest market in terms of IPO funds raised by technology companies.

In fact, just two days ago on this Tuesday, our Financial Secretary, Mr Paul Chan, announced the outcome of deliberations by the Financial Leaders Forum, which he chaired to discuss how we can improve Hong Kong's competitiveness in attracting listings of new economy firms, or innovation and technology firms. This was in the context of an ongoing consultation by the Stock Exchange of Hong Kong on the potential introduction of weighted voting rights (WVR) in Hong Kong, given that such structures are preferred by an increasing number of new economy firms, where the founders and senior management would like to maintain control over the strategic direction of the company while they raise capital on the Stock Exchange.

After deliberation, it has been concluded that there should be no need to create a new board in Hong Kong for companies with WVR. Instead, companies with such structures could be allowed to list on the existing main board, with provisions set out in a separate chapter in the listing rules.

In addition, it is also expected that secondary listing in Hong Kong of companies with WVR from overseas would be allowed too, subject to certain safeguards and conditions. The threshold for companies coming to Hong Kong for a secondary listing will be the same as those applying for IPOs, so that there will not be regulatory arbitrage. These measures to attract new economy firms, both for primary and secondary listings, would also target pre-revenue companies in biotech, an industry which is characterised by its focus on research and development. These companies may need a long lead-up time and heavy capital investment before bringing products to the market.

Let me reiterate - it is of utmost importance that there are appropriate safeguards for the protection of investors, and that there is a balance of market development on the one hand and market quality on the other hand. We expect the Stock Exchange to announce its consultation conclusions next month. This paves the way for further detailed consultation on changes to listing rules in the first half of 2018. And the plan is for our Stock Exchange to begin taking listing applications for companies with WVR structures in the second half of next year.

So indeed, building on the success of ZhongAn, which was the first major Fintech IPO in Hong Kong, we will build on our traditional strengths as a centre of choice for IPOs to attract even more new economy firms and Fintech firms to list in Hong Kong.

Ladies and gentlemen, to conclude, the Fintech revolution has its pulse beating in Hong Kong. Situated next to the vast market in Mainland China, Hong Kong is seeing much interest from around the world in making use of our market and regulatory environment as a testbed for innovation and a base for large clusters of entrepreneurs and tech professionals. As I mentioned above, Hong Kong is also taking the necessary steps towards becoming an IPO centre of choice for Fintech firms and we are ready to serve you, as and when you also ride on this wave of changes ushered in by Fintech.

Finally, I wish you all a fruitful and insightful conference. Thank you.

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