Building a Fintech Ecosystem to Shape the Future of Finance
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Good afternoon, everyone. Thank you for having me here.

We have a full room of global leaders from finance, business, academia and public sectors today. I believe one view we share in common is that technology is changing the face of everything, including financial markets.

Just look at this smartphone every one of us can't seem to let go of — one of the greatest inventions of the 21st century that we live upon. This small gadget of wonder penetrates almost every facet of our everyday life. It is everything rolled into one — camera, wallet, music player, video rental store, social media, e-book reader, even a key. We still call this a "phone" after all.

Gone are the days when business executives relied on landline telephones, fax machines, pagers, Personal Digital Assistants (PDAs), analogue mobile phones, and even blackberries. Behind the scenes of the digital revolution, many former household names have quietly faded out of consumers' minds one after another; others have been going through painstaking transformation.

The lesson is clear: today's innovators can fast become tomorrow's laggards. Failure to keep up with the times could cost your business dearly, even for the most prominent industry leaders.

Harnessing the power of technology: DLT in focus

Financial professionals are debating whether distributed ledger technology (DLT) would drive the same scale of revolution in the delivery of financial services as in consumer electronics. Nowadays, DLT has a number of useful applications in global finance (eg, in virtual assets (VAs) and trade finance), particularly as a rapidly developing underlying technology for the efficient and secure transfer of real-world assets. This would mean moving financial activities and transactions from traditional infrastructure onto blockchain. But are we at that inflection point yet? Could the delivery of all financial services on chain make the future of finance?

In the financial markets, DLT is used in VAs. Whether or not VAs like Bitcoin and Ether have any intrinsic value, most central bankers and economists would say "no". I do not disagree with this view. While the intrinsic value debate will continue, it is a fact that 15 years on, Bitcoin has survived multiple cycles of boom and bust, clearly showing its staying power as an alternative asset. More clearly, its underlying technology — DLT — is here to stay.

Note: This is the text of the speech as drafted, which may differ from the delivered version.

The potential benefits of DLT are plain to see. It has the potential to enhance efficiency and lower costs in the distribution, clearing, settlement, and custody of real-world assets. So far, a deep gulf has emerged between non-fungible tokens (NFTs), the metaverse and real-world assets. For instance, the art industry now offers digital artwork in the form of fractional, more affordable NFTs, revolutionising the ownership and transfer model and allowing more to take a share. Ether and stablecoins are being used as a medium of payment to trade tokenised comic images. Take the well-known Bored Ape Yacht Club (BAYC) as an example. Its release was all the hype back in 2021, but both its floor price and trading volume have plummeted of late. Understandably, many see NFTs as a speculative commodity.

While NFTs may be a fad, the enabling technology is being increasingly used in real-world assets. Increasingly, promoters are talking about real-world assets being given a "new life" in decentralised finance (DeFi) in recent years. Physical assets are being tokenised, such as plane tickets, Andy Warhol prints, fine art, collectibles and even real estate. The **potential** benefits of tokenising real-world assets include:

- First is financial inclusion, because it allows for fractionalisation of physical assets, which enables easier access to investment opportunities owing to a lower entry threshold for investors.
- Second is higher transparency and privacy for transacting parties at the same time. Financial institutions can achieve this by employing encryption to share ownership and transaction records confidentially.
- Third is greater settlement efficiency and lower costs, and indeed tokenisation can potentially enable atomic settlement. When trading and settling securities, it can reduce the number of counterparties, shorten confirmation and reconciliation time, and expand the use of delivery-versus-payment arrangements at lower costs.
- Transferability is fourth. Consider Claude Monet's *Waterlilies* or *Sunrise* as an alternative investment asset. Why would the owners lend them to museums? The reason is obvious – the cost of keeping them at home and awaiting appreciation would be sky-high due to expensive insurance premiums and home security systems. Arguably, for investment and safe custody purposes, tokenised Monet paintings could be stored in a secured warehouse like that of an auction house, and the token could be traded, owned and even collateralised for borrowing.

So, tokenisation may bring about wider financial inclusion, fractionalisation, custody and ownership, all on chain.

Putting traditional financial services and products on chain

The same potential benefits and efficiency gains could apply to the world of financial services, where primary issuance, secondary market trading, custody and hypothecation of traditional assets, such as bonds and money market funds, can all be done on chain. Such is the vision for the future of finance, which is particularly attractive when most existing financial infrastructure and cross-border payment system processes are under a T+2 cycle, even as some markets are driving towards T+1 or even T+0.

So far, this remains a vision and a lot more needs to be done to realise this vision. First, the DLT ecosystem needs to expand, scale up and mature to support institutional-grade financial services. This mainly has to do with the interoperability of blockchains across financial institutions and borders. It also has to do with finality, cross-border settlement and conflict of

laws. In particular, interoperability is essential to the development of Web3, which should ideally connect all blockchains in a secure manner.

In Hong Kong, the Web3 ecosystem is gradually being built up. Following the issue of the world's inaugural digital government green bond a year earlier, the Hong Kong SAR Government issued the second batch this February on a private blockchain that applied primary issuance, trading settlement, coupon payment and maturity redemption. Under the city's supportive legal and regulatory framework, the issuance of these HK$6.8 billion green bonds was a big success, attracting subscription by a wide spectrum of institutional investors globally.

The suite of digital product offerings is expanding. The Securities and Futures Commission (SFC) has authorised the first tokenised investment product — a gold token for retail access in Hong Kong, which allows investors to acquire fractional ownership of physical gold. It is represented by tokens recorded on an in-house private permissioned ledger using DLT. Each token represents 0.001 troy ounce of Loco London gold and is stored in the issuing bank's vault. Though without secondary market trading, investors can subscribe for the tokens or redeem them anytime online.

In addition, as part of Hong Kong's ecosystem for exchange-traded funds (ETFs), the SFC has authorised Asia's first batch of VA spot ETFs[1] for retail access. Trading of the six ETFs commenced at the end of April and has been orderly so far. As of 31 May, total market capitalisation amounted to US$301 million, with a decent daily turnover of US$5.8 million since listing.

Regulation driving fintech innovation

As a regulator, I keep hearing how innovation and regulation are opposing forces, but the truth is we are firm believers that the two should go hand in hand. Indeed, we have made it one of our strategic priorities for the next three years to transform financial markets through technology.

We are technology-neutral and adopt a "same business, same risks, same rules" principle. Investor protection is our primary focus. Back in 2018, when the global VA regulatory landscape was uncertain, we became one of the world's first major financial regulators to introduce a comprehensive policy response to VA-related activities with a focus on investor protection. We encourage tokenisation, and view it as a technology wrapper around traditional financial products like equities, bonds and funds. Last November, we issued a circular[2] setting out our expectations on issuers and distributers of such to be no less than that for securities.

In fact, additional guardrails are put in place to address the risks associated with emerging technologies, and this is where a regulator can come in to provide regulatory clarity and consistency. We believe the responsible use of innovative technologies will drive efficiency gains for the financial industry and foster a sustainable Web3 ecosystem in Hong Kong.

However, to make myself clear, our support for the Web3 ecosystem in Hong Kong should not be taken as an endorsement of the VA asset class. As things currently stand, VAs are

[1] The SFC provided guidance on SFC-authorised funds with exposure to virtual assets in a circular dated 22 December 2023.
[2] Please refer to SFC circular dated 2 November 2023.

highly speculative in nature with extreme price volatility. Therefore, while meeting investors' demand, we have made sure that wide-ranging safeguards are in place to protect investors. For spot VA ETFs, we require their VA transactions to be conducted only via SFC-licensed VA trading platforms, and their VA custody to be taken only by those platforms, or banks meeting the relevant standards. We also require their managers to provide risk warnings to investors. In addition, we have cautioned the investing public about the sharp volatilities of this asset class.

Hong Kong's Web3 ecosystem in the making

Block by block, Hong Kong is building a responsible and sustainable Web3 ecosystem. In June last year, our regulatory regime for centralised VA trading platforms came into effect. Acknowledging over-the-counter (OTC) VA dealing can be prone to fraud and money laundering, the Hong Kong SAR Government consulted the public earlier this year on a licensing regime for these OTC services providers[3]. This would complement efforts to develop a robust and transparent regulatory environment for VA dealing.

The VA regulatory remit would be further extended to cover stablecoins. Preparations for a new regime to regulate fiat-referenced stablecoins are underway. As we all know, stablecoins are generally issued by non-bank institutions and may be used for payments. Thus, regulating their issuers will help protect their holders. Recently, the Hong Kong Monetary Authority (HKMA) has completed a consultation on the proposed regime, including requiring stablecoin issuers to ensure full backing by high-quality and highly-liquid reserve assets.

At a product level, the SFC has provided guidance[4] on authorising tokenised investment products and on the conduct of licensed firms on dealing. The HKMA has also guided banks on operating custodian services for digital assets. The next phase of tokenisation is to achieve scale, and a centrepiece of this is Project Ensemble launched by the HKMA in March. The SFC is part of the Project Ensemble Architecture Community, which seeks to collaborate with the industry to support Hong Kong's tokenisation market development.

This new project on wholesale central bank digital currency will initially focus on tokenised deposits. As digital representations of bank deposits issued by commercial banks, they can be used for tokenised asset transactions. The core part of Project Ensemble is to harmonise the standards of blockchains to achieve interoperability, which is key to scale up secondary market trading and hypothecation. A sandbox will be launched to pilot tokenisation use cases, including trading and settlement of tokenised products, such as green bonds and carbon credits.

Staying relevant in the digital age

In closing, one thing we would all agree on today is that technological advances have brought about a seismic shift in financial markets. We do not know whether or when traditional financial services rendered on traditional infrastructure would give way to smart contracts and DLT. The job of interested market practitioners is to pilot use cases, whereas

[3] This includes requiring any person who conducts a business in providing services of spot trade of any VA for money in Hong Kong to be licensed, irrespective of whether the services are provided through a physical outlet and/or other platforms.

[4] See SFC circular dated 2 November 2023.

our job as a regulator is to provide clarity, certainty and consistency in our regulatory framework to facilitate use cases under a safe environment for investors.

You might have heard this saying before: if you find technology disruptive, chances are you are not quite ready to embrace it. As I said at the beginning, those household consumer brands that have lost their shine serve as a stark reminder to stay relevant in this digital age. Or the innovation train will just move ahead without some of us.

Championing responsible innovation and building a fintech ecosystem would take time, but we are all in this together to prepare ourselves for the future of finance. To drive greater success for financial markets, the worlds of traditional finance and Defi must meet and we are enabling this as regulators. The future is now, and this is an important time to unlock new opportunities.

Thank you.