SECURITIES AND FUTURES COMMISSION
證券及期貨事務監察委員會

Fintech: the regulatory response to evolving challenges
Keynote address at Hong Kong FinTech Week

Mr Ashley Alder
Chief Executive Officer

3 November 2020

Since March, global regulators have been concentrating on their responses to COVID. Our actions ranged from how to supervise firms whose employees were mainly working from home to the measures necessary to safeguard the stability of the financial system after the March "dash for cash" episode.

Fintech was a major topic on the global regulatory agenda prior to the COVID outbreak. The growth of digitalisation and the use of social media were already rapidly changing the way in which financial products were being marketed and distributed. In the immediate run-up to the COVID crisis, we saw the wider adoption of consumer financial technologies, from remote banking to wireless payments.

Through all of this, the Securities and Futures Commission (SFC) has emphasised that it fully supports the use of innovative financial technology which provides clear benefits. These can include improving the customer experience, increasing financial inclusion or making markets more efficient and reliable.

With COVID a dominant fact of life globally, financial technology can help enable social distancing in the business world. Online account opening and hygiene-friendly contactless payments are just two examples. And with so many people working from home, we have also seen an accelerated use of regulatory and supervisory technology.

Virtual asset trading platforms

At this event last year, I announced a new regulatory framework for "virtual asset" trading platforms.

This was against the background of the growing popularity of cryptocurrencies, or virtual assets, and reports about fraud, market manipulation and abusive activities on crypto-exchanges or trading platforms.

The framework was based around our power to regulate virtual assets which fall under the definition of "securities" under the Securities and Futures Ordinance (SFO). Basically, if a trading platform offers at least one virtual asset which is classed as a "security", our rules can then apply to all the platform's operations, including other virtual assets traded on the platform which are not actually "securities".

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

The upshot was that platform operators could apply to be regulated by the SFC. This was a big change, and has been pursued by quite a few crypto-exchanges. However, this is essentially an opt-in approach, which is a significant limitation. Under the current legislative framework, if a platform operator is determined to remain completely off the regulatory radar, it can do so simply by ensuring that its traded crypto-assets are not within the legal definition of a “security”.

This is about to change. Today, the Government proposed a new licensing regime under the Anti-Money Laundering Ordinance for platforms which trade any type of crypto-asset, even if none are classified as securities. So if they are operating in Hong Kong, or target Hong Kong investors, they would need to apply for an SFC licence. Failure to do so would be an offence.

The SFC would have the ability to assess licence applications, ensure compliance, monitor the firms’ daily operations, investigate any irregularities and enforce the rules – basically engaging the whole range of our regulatory functions.

Successful applicants would be subject to expectations covering their financial resources, experience and the soundness of their business and risk management. Given the risks involved, the proposal is that they should offer their services to professional investors only, at least initially.

Once this new regime is in place, all virtual asset trading platforms in Hong Kong would be regulated, supervised and monitored under one of two regimes: the existing opt-in framework we introduced last year, or the proposed new licencing approach being announced today.

Both regimes will impose the same regulatory standards, guaranteeing a level playing field for all operations. And both will benchmark against the well-understood regulatory principles which apply to securities brokers and other trading venues. The overarching principle is “same business, same risks, same rules”.

Most importantly, the new regime will allow us to mitigate risks to investors whilst fulfilling our international obligations around money laundering and terrorist financing.

Regulation of security tokens

Recently security token offerings, or STOs, have attracted a lot of interest. Security tokens have all the features of traditional securities offerings, but are digital representations of ownership of assets such as real estate, or economic rights such as a share of revenues. They can be issued directly onto a blockchain, or can be a paper interest converted into digital form.

In Hong Kong, we already have a regulatory framework in place which covers both the primary distribution and secondary trading of security tokens.

Regulation of primary distribution is fairly straightforward. The tokens will likely qualify under the definition of “securities” in the SFO. Where they are offered to professional investors, our authorisation process and prospectus registration regime would not be triggered. However, any person who markets and distributes these tokens is required to apply to the SFC for a licence to deal in securities.

The secondary trading of security tokens is subject to the same licensing framework for virtual asset trading platforms which I announced last year. That is, if a platform trades virtual assets at least one of which is a security token, the operator should apply for a dealer's licence (Type 1) as well as a licence to provide automated trading services (Type 7). And in that case, the operator should only offer its services to professional investors.

If your firm is thinking about engaging in activities related to security tokens, you are welcome to discuss your plans with us.

The broader picture

So far, I have mainly focussed on the regulation of crypto-assets as this is an area where Hong Kong is continuing to adapt its rules to keep pace with more innovation, recognising that crypto-assets are here to stay.

Zooming out to the broader Fintech scene, it is clear that activities which had been seen by regulators to be niche areas in finance, requiring things like sandboxes to enable new ideas to grow, are now firmly here to stay and are of major importance.

Many have commented that without flexible connectivity across markets enabled by technology, and the ability of regulators to supervise remotely, financial services would have been under even greater strain during the COVID-19 crisis. That is certainly true.

But it is much more than that. Regulators are now focussing on new, ground-breaking changes in finance all of which are basically Fintech innovations. At the most fundamental level there is an increasing focus on digital central bank currencies, which could be revolutionary. These are being looked at seriously not only in mainland China, but also in Europe.

Then there are potentially important changes in the way in which cross border payments are processed – more efficiently and at lower cost.

In fact both of these tracks are partly a response to Facebook's original Libra proposals, which challenged governments to think hard about the possibility and risks of privatised digital global currencies, including the potential risks to financial stability.

At a more granular level, regulators are spending more and more time thinking about the implications of cloud computing, artificial intelligence, machine learning and more sophisticated algorithms, as well as the outsourcing of crucial aspects of financial services to unregulated tech firms.

So in conclusion I can confidently predict that we will have even more to talk about at next year's FinTech Week.