

Fintech and Regtech: A Securities Regulator's Perspective

Hong Kong Fintech Week 2016

Reuters Risky Women's Breakfast

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Reuters has kindly invited me to this 2016 Risky Women's Breakfast to give a brief overview of financial and regulatory technologies from the perspective of a securities regulator.

As a woman and a strong supporter of diversity, I am very pleased to speak at this event. I am also extremely honoured to be speaking alongside Mrs Meena Datwani, Executive Director (Enforcement and AML) of the Hong Kong Monetary Authority, with whom I share a passion for diversity and inclusion.

Incidentally, I am glad to share that as part of Hong Kong Fintech Week¹, the Securities and Futures Commission (SFC) hosted an "SFC Regtech and Fintech Contact Day" on 7 November². For those of you who missed this event, I encourage you to check the SFC website for a synopsis which will be posted soon.

While I have too short a time to give detailed views, let me hereby cover some key points, including: what financial and regulatory technologies are, their intersection with securities regulation, the SFC's Fintech and Regtech work, as well as what I think lies ahead.

What are financial and regulatory technologies?

The term financial technologies, or "Fintech", is used to describe not one business model or technology, but rather a variety of business models and emerging technologies that have the potential to supplement or disrupt the financial services industry.

Innovative Fintech business models typically offer one or more specific financial products or services in an automated fashion through the use of the internet. Examples most commonly cited in the media include robo-advisors as well as platforms for investment, trading, peer-to-peer lending and equity crowdfunding.

For emerging technologies, examples include big data analytics, cognitive computing, machine learning, artificial intelligence and distributed ledger technology.

A related term, regulatory technologies, or "Regtech", is typically used to describe technologies used by regulatees to comply with regulatory requirements more effectively and

¹ <http://www.hongkong-fintech.hk/en/index.html>

² http://www.hongkong-fintech.hk/en/files/SFC_Fintech_Contact_Day_7Nov16-Program.pdf



efficiently. They are also used to describe the deployment of technology by regulators themselves to supplement risk monitoring, surveillance and supervisory capabilities.

The intersection with securities regulation

To answer the question of intersection with securities regulation, it is best to distinguish between Fintech and Regtech.

Let me start by noting that, like most global securities regulators, the SFC is technologically neutral, which means that it is open-minded about licensed corporations and new entrants deploying technologies that achieve the right results under our rules and standards.

Fintech

As the name indicates, Fintech is at the intersection of finance and technology. Because finance is a regulated industry, it logically follows that the delivery of regulated activities in Hong Kong through the use of technology typically enters the remit of the SFC.

For example, investment platforms such as robo-advisors typically advise on and deal in securities, which in Hong Kong are regulated activities under the Securities and Futures Ordinance. Persons conducting business in Type 1 (dealing in securities) and Type 4 (advising on securities) regulated activities are required to be licensed by or registered with the SFC.

Thus, investment platforms enter the regulatory remit and SFC licences are required to conduct this type of business. Similar requirements also apply to equity crowdfunding, peer-to-peer lending and trading platforms.

Keeping this in mind, we are encouraged to see Fintech innovations that endeavour to improve investor outcomes (for example, through greater customer centricity, higher comparability of investment options, and increased transparency of fees and returns on investment) or that serve to enhance Hong Kong's position as an international financial centre.

Regtech

There is an increasing focus on Regtech. Fintech and Regtech are, in my view, complementary. They are often adopted in conjunction, and are rapidly developing in tandem.

For example,

- As Fintech firms automate the delivery of financial services, they need client onboarding, authentication and fraud control technologies that are more automated, yet equally or more secure.
- More advanced cyber security technologies are needed as more investors share their personal data with Fintech platforms, creating cyber and data privacy risks.
- Finally, Fintech platforms and business models often thrive on their ability to make use of the cloud, further spurring the need for cloud security.



Regtech intersects with the SFC's remit in two ways:

- First, it can be used to achieve greater compliance and risk control by those we regulate, including both traditional intermediaries and Fintech players.
- Second, we can use some of these technologies to supplement our own risk monitoring, surveillance and supervisory capabilities.

Needless to say, we are encouraged to see Regtech innovations, especially those that can be used to achieve more efficient and effective security, compliance and risk outcomes, or that can be used by us to enhance our risk monitoring, surveillance and supervisory capabilities.

In sum, while it is clear that Fintech often constitutes regulated activities and thereby intersects with the SFC's remit, Regtech may assist regulatees in ensuring compliance with our regulatory standards and may assist the SFC in performing its regulatory role.

Therefore both are of interest to us. Accordingly, we listed each of these areas on the landing page of the Fintech Contact Point on the SFC website, which I will tell you more about in a moment³.

SFC's Fintech and Regtech work

This brings me to my third point, which is what the SFC has been doing in relation to Fintech and Regtech.

First, we were very honoured to be part of the Hong Kong SAR Steering Group on Fintech. In February 2016, this group released a report which is publicly available. The report proposes a number of recommendations to further Hong Kong's development as a Fintech hub and provides an excellent compass for Fintech players who are new to Hong Kong⁴.

We also launched a number of new initiatives to foster communication with the Fintech community:

- Throughout 2015, we conducted a series of industry meetings with large global financial institutions to understand their perspective on, and adoption of, financial and regulatory technologies.
- On 1 March 2016, the SFC announced the establishment of a Fintech Contact Point (FTCP). The FTCP is a centralised point of contact at the SFC for Fintech and Regtech innovation, aimed at further enhancing communication with external stakeholders.
- I am glad to say that we are now into the ninth month of operation of the FTCP. To share some of the insights gained in this capacity, we hosted the first SFC Regtech and Fintech Contact Day on 7 November. We were honoured that the Acting Secretary for Financial Services and the Treasury, Mr James Lau, delivered the opening speech, providing an overview of the government's initiatives to foster Hong Kong's development as a Fintech centre⁵.

³ <http://www.sfc.hk/web/EN/sfc-fintech-contact-point/>

⁴ http://www.fstb.gov.hk/fsb/ppr/report/doc/Fintech_Report_for%20publication_e.pdf

⁵ <http://www.info.gov.hk/gia/general/201611/07/P2016110700411p.htm>



- The FTCP also acts as the central contact point for externally available financial and regulatory technologies to assist the SFC in better identifying, categorising and analysing risks. We continue to encourage firms that have offerings that enable the identification of risks in the Hong Kong securities and capital markets to contact the FTCP.
- We also launched an external expert committee, consisting of market practitioners. They have been very helpful in guiding us to better understand the main trends in Fintech and Regtech that are happening overseas and may eventually reach Hong Kong.
- And we launched an internal Fintech committee. When we learn of new business models or emerging technologies, or when Fintech or Regtech firms approach the FTCP with questions, we deliberate these issues within the internal committee. Fintech and Regtech are a learning journey for us all, and communicating internally is key.
- This internal communication in turn lays the foundation for assessing how these new business models intersect with our own rules and regulations. For example, the SFC has created an internal working group focussed on clarifying the SFC's expectations on how regulatory suitability requirements should be implemented in the online context. The SFC also issued a circular on "Client identity verification in account opening process", that amongst other things, clarifies our current position on non-face-to-face on-boarding⁶.
- Finally, through our CEO Ashley Alder's Chairmanship of IOSCO⁷, the SFC is part of a vibrant global regulatory dialogue. In my capacity as the Vice-Chair of the IOSCO Committee on Emerging Risks, I lead the Workstream on Financial Technologies, allowing us to gain a global perspective on the topic.

These activities have kept us very busy. We communicate with Fintech and Regtech stakeholders almost on a daily basis. We hope to keep it this way because Fintech and Regtech are evolving very fast and have the ability to materially change the future of finance.

What lies ahead?

No one has a crystal ball to look into the future, but in the context of IOSCO and of the FTCP, we have performed research on what is already happening globally.

This research, combining the observation of key trends such as the exponential growth in computing power, generational changes, broader access to and the decreasing cost of goods and services, and increasing disintermediation and re-intermediation, has led me to the conclusion that we are at the crossroads of significant technology-driven change in the offering of financial services (Fintech), and the control thereof (Regtech).

Fintech and Regtech applications are developing at a much faster pace than ever before, creating new opportunities to achieve better investor outcomes and more efficient and effective security, compliance and risk outcomes. At the same time, as with any change, new risks and vulnerabilities arise that require close regulatory understanding.

⁶ <http://www.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=16EC50>

⁷ International Organization of Securities Commissions



This transformation of the financial services industry has a series of implications that require strategic consideration by new entrants, existing firms, regulators and investors:

- New Fintech business models often are a lot more than “technology or information platforms”, and instead deliver financial services as defined in standing rules and regulations. For Fintech start-ups, this means they need to understand and comply with regulatory expectations, including those in overseas markets where their offering is advertised.
- New technology-driven Fintech business models may challenge and disintermediate the business lines of traditional brick and mortar companies. As it is customer-centricity that is driving the adoption of Fintech, these developments provide a reminder to focus on “what customers truly want and need”. At the same time, Regtech innovation can be used by companies to achieve more effective and efficient security, risk and compliance outcomes.
- New Fintech business models already operate across borders, or it is highly likely they will want to expand into other global markets. It is important for regulators to communicate globally, so as to better anticipate how these new business models intersect with jurisdictional regulation. Regulators can also explore how to best benefit from the Regtech trend, for example, by better leveraging data and data analytics tools and software.
- New Fintech business models empower investors to access new financial products and services, often across borders. They also enable investors to better compare the products and services offered. With this increased empowerment comes increased responsibility. Investors who make investments on overseas platforms that are not licensed in Hong Kong need to understand that such cross-border investments may be outside the SFC’s regulatory remit.

Finally, as our Chief Executive Officer Mr Ashley Alder noted at the SFC Regtech and Fintech Contact Day, increased automation by firms, new entrants and regulators requires new skills and proper record keeping. Code is written by humans. It should be properly documented, understood and supervised by humans.

I hope that I have hereby provided more clarity on what financial and regulatory technologies are, their intersection with securities regulation, the SFC’s Fintech and Regtech work, as well as what I think lies ahead.

May I also close by saying that Fintech and Regtech are creative fields, ideally suited for Risky Women like you, attending this breakfast. I encourage you to keep learning about this trend as technology has been, and promises to become even more, important to the compliance and risk professions.