

## Update on SFC Fintech initiatives Clifford Chance Asia Pacific Funds Conference

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**23 May 2017**

Given that in the past two years I have spent a considerable amount of time on the topic of Financial and Regulatory technologies (Fintech and Regtech) and that we have just passed the first anniversary of the SFC Fintech Contact Point, I thought it may be helpful if I share some thoughts and observations on this topic.

### **The shape of things to come**

Let me start with an anecdote. Twenty years ago, in 1997, keenly interested in history, I sat at my computer, clicked my mouse and bought a porcelain plate from the Dutch East India Company on eBay. It was the first time in my life that I could sit at my desk and with the simple click of a mouse buy such a wonderful piece remotely. Jeff Bezos had started Amazon barely three years earlier, and was delivering packages to the post office himself. It was the start of e-commerce, the start of PayPal, and the start of a brave new world.

Fast forward 20 years and where are we today? Amazon is the fifth largest company by market capitalisation. Its revenue is growing much faster than that of well-known brick-and-mortar department stores. Six of the top 10 companies by market capitalisation are either technology companies or companies for which technology is central to their strategy. PayPal's market capitalisation is USD60 billion, larger than that of some of the world's leading banks.

Things have changed a lot over these past 20 years. And things will keep on changing. In the words of the World Economic Forum, "the world is experiencing the fourth industrial revolution." So what does this mean for finance? China offers us a glimpse into the future. For example:

- For centuries it was difficult to imagine what could take the place of banks in the pricing of credit risks. But due to advances in technology and credit data analytics, non-banks are now stepping into this space. As of 2015, peer-to-peer lending in China surpassed USD90 billion.
- As of April 2017, the market capitalisation of Tencent surpassed USD300 billion, placing it in the global top 10 companies by market capitalisation. Tencent started its business in gaming and messaging. Through its WeChat platform, it extended into financial services. It operates Tenpay, which has over 600 million active users.
- Ant Financial was founded in 2014. Its private market valuation is higher than the market capitalisation of some of the world's leading banks which were founded over 100 years ago. Ant operates Alipay and Yu'e Bao. Yu'e Bao's size surpassed USD165 billion, making it the world's largest money market fund.



As these examples show, the digital revolution has firmly reached the doorstep of finance.

### **Actions taken by Hong Kong and the SFC**

The SFC has undertaken a series of proactive steps to capture the opportunities and balance the risks that this evolution presents.

#### *Launch of the SFC FinTech Contact Point*

In March 2016, the SFC became one of the first global securities regulators to launch a dedicated Fintech Contact Point. The contact point is supported by an internal Fintech committee comprised of representatives from across the SFC. It is also supported by the SFC's Fintech Advisory Group, which is comprised of industry experts who have a wide range of Fintech and Regtech expertise, including in blockchain, online platforms and venture capital investment. Since its inception a year ago, the SFC's Fintech Contact Point has met with over 200 Fintech and Regtech players.

Through open interaction with the market, the SFC hopes to see the continued emergence in Hong Kong of financial technologies that can give investors greater choice and flexibility without compromising their protection. The SFC also looks forward to seeing technologies that facilitate more efficient and effective regulatory compliance, including regulatory reporting, risk monitoring and cyber risk control.

#### *Regtech project*

In June 2016, the SFC tendered for its internal Regtech project. A pilot project is underway whereby the SFC is assessing which risk data could assist the SFC in its ongoing supervision.

In tandem, we are exploring useful external systems that may help us achieve our regulatory objectives. For example, the SFC also undertook a methodological comparison of social media sentiment analytics tools that make use of big data analytics, machine learning and natural language processing.

#### *IOSCO Fintech research report*

In February 2017, the International Organization of Securities Commissions (IOSCO) research report on Fintech was released. The SFC acted as the global report lead. The report was the first-ever methodological analysis of the intersection of Fintech with securities regulation.

Four key areas were identified: alternative financing platforms (including P2P lending and equity crowdfunding), retail investment platforms (including robo-advice and social trading), institutional investment platforms (including continued automation of trading), and distributed ledger technology (DLT).

Recognising that most of you here today are asset managers, let me highlight a few developments cited in the report which may be of interest:

- Robo-advisors have seen rapid growth, offering a lower fee alternative for smaller affluent investors, a segment often underserved by retail and private banks. As of 2017, AUM at robo-advisors (excluding robo-advisory services provided by private banks) stands in excess of USD100 billion. Given that robo-advice only emerged a few years



ago, this is very rapid growth. The growth of robo-advice goes hand in hand with more investment in ETFs.

- Online investment and trading continue to evolve, allowing retail users to self-direct their activity across a much broader range of asset classes, and with more information and analytics than was conceivable even five years ago.
- Artificial intelligence, machine learning and big data analytics are increasingly used to supplement or automate trading decisions, as well as to further automate compliance and risk management. This journey is only at its inception, and is set to continue.
- Equally, DLT is only beginning to be applied to securities markets. A large number of start-ups, incumbents and consortia are piloting a series of use-cases that could be transformative. For example, DLT has been piloted for venture capital raising and corporate primary capital raising. It is also being piloted to create cost efficiencies in settlement, to register identities, and to automate corporate actions.

#### *SFC technology circulars and guidelines*

Throughout 2016 and 2017, the SFC issued a series of circulars and guidelines that concern technology and online platforms:

- In October 2016, the SFC issued an Advisory Circular clarifying our position on client identity verification in the account opening process. The circular explained that under section 5.1 of the Code of Conduct<sup>1</sup>, non-face-to-face account opening is possible under certain conditions.
- Just this month, in May 2017, the SFC issued a Consultation Paper on New Guidelines on Online Distribution and Advisory Platforms, in which we clarified our position on suitability in the online context. This consultation also includes guidelines on robo-advice. It is open for comment until 4 August 2017.
- Also in May 2017, the SFC issued a Consultation Paper on Proposals to reduce Hacking Risks in Internet Trading. This consultation is open for comment until 7 July 2017.
- Cyber risk is widely acknowledged as a by-product of increasing automation, and – as WannaCry so unkindly reminded us barely a week ago – an omnipresent risk. The SFC is therefore also undertaking other efforts:
  - In March 2017, the SFC hosted the launch meeting for the second industry-wide crisis simulation (WISE) to take place on 27 October 2017. Approximately 30 leading financial institutions, including leading asset managers, have signed up to improve their cyber and risk management awareness. There is still time to sign up through the Hong Kong Financial Services Business Continuity Management Forum website.
  - In addition, licensed corporations have been invited to Cybersecurity Workshops which the SFC will host jointly with the Hong Kong Police Force and the Hong Kong Computer Emergency Response Team Coordination Centre.

#### *360-degree Collaboration – Locally and Globally*

There is a strong desire to collaborate on Fintech and Regtech across regulators, as well as across the public and private side. In May 2017, the SFC signed the first international Fintech

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<sup>1</sup> The Code of Conduct for Persons Licensed by or Registered with the SFC



cooperation agreement. We also have regular calls with regulators in Europe and Asia to discuss innovation, and we stay in step with global trends through IOSCO.

Locally, the Fintech offices of each of the regulatory authorities meet regularly. This collaboration led to the first-ever Hong Kong Fintech Week in November 2016, to be repeated in October 2017 at the Hong Kong Convention Centre. As part of last November's event, the SFC hosted the Fintech and Regtech Contact Day which was attended by more than 150 representatives from our licensed corporations, including many members of the asset management community and the Hong Kong Investment Funds Association, some of whom may be in this room.

### **Conclusion**

We have been very busy, working on a multidisciplinary, One SFC basis, to ensure that the SFC is prepared to capture the opportunities, while balancing the risks that change invariably presents. We have done a lot of work, but more work is ahead.

To learn more, feel free to visit the webpage of the [SFC Fintech Contact Point](#), including the "useful links" to access some of the documents I mentioned.