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Hong Kong securities regulator launches fintech sandbox

Oct 03 2017 Ajay Shamdasani, Regulatory Intelligence

Hong Kong's Securities and Futures Commission has issued a circular announcing the launch of the SFC Regulatory Sandbox. The policy goal is to provide a confined regulatory environment in which qualified firms can conduct regulated activities using financial technology (fintech).

The sandbox aims to enable qualified firms, through close dialogue with and supervision by the territory's capital markets regulator, to identify and address any risks or concerns associated with their regulated activities before their services can be provided to the wider public.

"For the sake of market integrity and better investor protection, the sandbox provides a confined regulatory environment for qualified firms to demonstrate the reliability of their fintech solutions as well as their internal control systems at the initial stage," said Ashley Alder, the SFC's chief executive.

Most industry officials have supported the initiative.

"It is certainly a welcome initiative and could potentially be very impactful. In order to understand how impactful, however, we will need to see some detail on the actual authority of the sandbox structure," said James Lloyd, Asia-Pacific fintech leader at EY in Hong Kong.

"What is the scope of their authority as it relates to granting waivers, restricted authorisations, no enforcement action letters, or flexibility around licensing requirements?" he said.

Entering the fray

To be qualified to enter the sandbox, entities must be either licensed corporations or startup firms which intend to carry on regulated activities. They must also be fit and proper, use innovative technology and be able to demonstrate a genuine and serious commitment to carry on regulated activities through the use of fintech. A firm's establishment or its activities should also increase the range, and quality of products and services for investors, and benefit the city's financial services sector, the SFC said.

"In the sandbox environment, qualified firms will be under closer monitoring by the SFC," the regulator said. "To minimise risk exposure to investors, the SFC may impose licensing conditions such as limiting the types of clients these firms serve or each client's maximum exposure."

Once firms have demonstrated their services are reliable and that their internal controls adequately address any identified risks, they may apply for the removal or variation of some or all of the licensing conditions.

"In addition, they are expected to have adequate investor protection measures in place. The circular emphasises that the sandbox should not be viewed as a means to circumvent legal and regulatory requirements. If the SFC considers that a firm operating in the sandbox is not fit and proper to remain licensed, its licence may be revoked," the regulator said.

Daniel Döderlein, founder and chief executive of mobile payments firm Auka in Oslo, saw the development as an opportunity both to stimulate entrepreneurs and to create new businesses in the financial services sector.

"It will enable more players to play around, but under strong scrutiny by the regulator. This means that they most probably do not get to do stuff that breaks the law. For example, enrolling customers without know-your-customer compliance," he said.

"I do not read the intentions of a sandbox to be 'flexible' in terms of lax security or compliance," Döderlein said.

The SFC has also issued a separate circular "to clarify its approach in assessing the 'relevant industry experience' requirement for individuals including those with technological expertise applying to be responsible officers".

Greater regulatory cooperation

The SFC's move has come at almost the same time as the local banking regulator's announcement of seven new fintech initiatives, which include a repackaging of the Hong Kong Monetary Authority's faster payments system, to be launched next year. The HKMA has also announced that it will open up its fintech supervisory sandbox to technology companies and create a new policy opening up banks' application programming interfaces to technology players.

The HKMA's Enhanced Fintech Supervisory Sandbox (FSS) 2.0 has three main features:

- A Fintech Supervisory Chatroom will be established to provide swift feedback to banks and tech firms at an early stage of their fintech projects.

- Tech firms may have direct access to the sandbox by seeking feedback from the chatroom without necessarily going through a bank.

- The HKMA's sandboxes and those of the SFC and the Insurance Authority will be linked up so that there will be a single point of entry for pilot trials of cross-sector fintech products.

"The FSS 2.0 will be launched by the end of 2017," the HKMA said.

HKMA's sandboxes are open to not just the authorised institutions (AIs) it regulates under the territory's Banking Ordinance but also to fintech firms. This would be ideal for startups which may be straddling multiple regulatory regimes and works towards the broader goal of greater coordination between the SFC, HKMA and the newly formed Insurance Authority.

The emergence of multiple regulatory sandboxes within a single jurisdiction, at the regional level or at the industry-level with industry certification, is already happening in ASEAN, and was anticipated in a recent EY position paper.

Proceed with caution

Some officials expressed concern about the fact that it was regulators who were driving the process, rather than the private sector. The initiative was welcome but the devil would be in the detail, a source said.

"The real question is: when the time comes, will they [regulators] be able to implement their plans? Hong Kong's fintech is still up-and-coming, so they need to be more cautious and have a longer learning curve. That is different from Singapore, where the Monetary Authority of Singapore is going at it a lot harder," he said.

Regulators and policymakers first needed to understand the "technological mindset" before the "financial mindset" in this case, said a local entrepreneur, speaking on condition of anonymity. "Only then can they apply 'fin' to 'tech' and then devise ways of regulating it."

This means regulators will need to hire more engineers, programmers and technology experts rather than former bankers, lawyers and accountants.

"Before you set up a sandbox, you need the technical mindset. Hire people from Google or Facebook before implementation. You definitely do not want it run by finance guys. I would rather it be overseen by a former techie than an ex-banker or lawyer," the entrepreneur said.

"I do not think it is the regulator's place to encourage innovation and drive it forward. The best advances come from the private sector," he said.

Ajay Shamdasani *is a senior regulatory correspondent with Thomson Reuters Regulatory Intelligence in Hong Kong. He covers regulatory developments in Hong Kong, India and South Korea. He also writes about money laundering, tax evasion, fraud, corruption, data privacy and cybercrime.*