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Multiple regulators hindering Hong Kong's fintech potential, say innovators

Dec 15 2017 Ajay Shamdasani, Regulatory Intelligence

Fintech innovation could be hampered in Hong Kong due to the complexities of dealing with four different financial regulators and resistance from incumbent financial institutions. Industry officials from across Asia and Europe said the uptake of fintech in the city-state would be limited unless barriers to innovation were eliminated.

The fixation on bitcoin and other cryptocurrencies was also taking the focus off modernising local mobile payment systems, experts said.

"Singapore has a slight advantage over Hong Kong in one respect and that is that Monetary Authority of Singapore (MAS) is a financial services regulator. In Hong Kong, we have four regulators … a banking regulator, a securities regulator, a pension fund regulator and an insurance fund regulator," said Duncan Fitzgerald, a partner at PwC in Hong Kong. His comments were made during a panel discussion at the recent Asia Securities Industry and Financial Markets Association's (ASIFMA) 2017 annual conference in Hong Kong.

Fintechs in Hong Kong may have to deal with the Securities and Futures Commission (SFC), the Hong Kong Monetary Authority (HKMA), the Insurance Authority (IA) and the Mandatory Provident Fund Schemes Authority (MPFSA). With four regulators to navigate, the result is higher start-up costs for industry entrants.

Singaporean start-ups only have to liaise with one agency: the MAS.

Hong Kong's complex regulatory regime can also make it difficult to determine which regulators will have oversight over any given fintech solution. This is true despite the HKMA, SFC and IA creating fintech sandboxes in the latter half of 2017, which will aim to be interoperable.

The challenges of implementing fintech and regulatory technology (regtech) in the Special Administrative Region (SAR) should also be seen in the light of financial services companies leveraging new technologies to manage their own risk and improve their own regulatory reporting.

There is also the matter of regulators leveraging technology to supervise authorised institutions and manage market risk. The question for the territory's financial institutions and their regulators is whether they are suitably equipped to manage this technological shift.

"The benefit of fintech is that you can manage risk better," said Yao Loong Ng, executive director and head of markets policy and infrastructure at the MAS. He spoke at the aforementioned ASIFMA event in late-November.

Little incentive for improvement from established institutions

Large, established financial institutions dominate Hong Kong's local market. A total of 29 of the world's 30 most systemically important financial institutions have a presence in the SAR.

"[Hong Kong] is not a place where technological change is driven by smaller fintech market disruptors. This dominance of incumbent financial institutions is evidenced by some of the regulatory responses," Etelka Bogardi, a partner with law firm Norton Rose Fulbright in Hong Kong.

"Unlike the UK or Singapore, the regulatory sandboxes are available only to institutions that are already licensed or those that have partnered up with licensed financial institutions."

It is likely that the implementation of fintech in Hong Kong will be driven by existing institutions partnering up — or investing in — fintech start-ups. This may result in the pace of disruption being slower than in jurisdictions where fintech development is more disruptor-driven," Bogardi said.

Mobile payments are only now starting to see real traction locally, yet neighbouring countries are much further advanced.

Mobile payment innovation is key

The challenges associated with mobile payments for traditional financial institutions in Hong Kong was definitely around the threat of disruption by third-parties, said Daniel Doderlein, chief executive and founder of Auka, a mobile payments firm in Oslo.

"Once third parties get a clear foothold on payments they then own valuable customer data, which they can monetise. If banks take the necessary steps to partner with fintechs to build their own mobile payments platforms tailored to the needs of the local market, they'll be in a better position to maintain relevancy," he said.

With the flurry of recent press coverage surrounding bitcoin, Doderlein suggested the focus was being taken off further advancing the city's other financial and payment systems.

"Bitcoin is the topic *du jour* right now in Hong Kong and across the globe. I really hope the hype dies down as we head into 2018 as it is damaging to the overall fintech environment. It is overshadowing the real problems and opportunities in financial services and payments," he said.

More focus was needed on improving mobile payments, which were just starting to get a meaningful foothold in the city.

The coming year may also sound the death knell for near-field communication (NFC) or contactless payment.

For example, 2017 saw Google — the current market leader — Apple, Facebook, Amazon and several other larger players jumping on board the mobile payment bandwagon, Doderlein said.

"They all seem to be following the same formula as the mobile payments schemes, which have enjoyed so much success in China and in my native Scandinavia — both of which do not rely on NFC. All the big players have started to realise that contactless payments are not what the market needs. Instead, the focus will be on creating systems which democratise payment and money," he said.

While the challenges expected in mainland China were around a prevailing reliance on cash, they had been successfully overcome, certainly in the country's more urban regions.

Citing the mainland Chinese example as a success, Doderlein said: "I do not see fintech innovators in Hong Kong getting too hung up on this as a potential barrier to launching new mobile payments systems."

Therefore, 2018 may see an arms race of sorts when it comes to companies seeking ways to transform the e-commerce experience through better digital payments.

"Amazon has a great e-commerce experience but lacks the channel to reach consumers across the globe right now. Facebook has an app that lives in virtually everyone's back pocket but they haven't cracked the payment and commerce side of the equation yet. Alipay has nailed a model where commerce, payments and a social network work harmoniously together but they still lack widespread trust outside of China," Doderlein said.

Banks are struggling with all the above concerns, although they have a big advantage when it comes trust and distribution capability.

"Next year will be the most interesting yet for fintech innovation across the globe. There will only be one true winner in each region when it comes to mobile payment and e-commerce," Doderlein said.

"In Hong Kong, it is not yet clear whether that winner will be a banking underdog, one of the big Silicon Valley tech companies or the likes of Alipay. For it to be the banking incumbents, we have seen in the Nordics that a completely new unified strategy is required."

New entrants face bureaucratic inertia

A lot of non-traditional players seeking to work with established financial services providers have come up against obstacles.

"Often the complaint from startups is: 'Yes, banks have innovation teams, incubators and open application programming interfaces (APIs), but when we deal with individual business units within the bank it is the same procurement and risk management policies as before. Even in terms of business case, many are just not set up to deal with fintechs," said James Lloyd, EY's Asia-Pacific fintech leader in Hong Kong.

One entrepreneur from Singapore, who attended the Insurtech Rising conference in Hong Kong earlier this week, said it was simply too cumbersome to deal with large insurance or reinsurance firms. They lacked both vision and technical know-how, he said.

It was "easier to deal with private equity or high-net-worth individuals and get them to see the value of emerging fintech solutions and get funding than to deal with established financial players, who are content to use devices from yesteryear," he said.

The challenge, Lloyd said, was "often one of mindset, ambition, and vision," coupled with the difficulty of attracting talent.

"Regulators and compliance teams need to prepare for a different competitive landscape which, among other things, will include more technology-driven, non-traditional financial services players. Perhaps the key consideration is how to align the delivery of financial services with faster, more scalable technologies," Lloyd said.

Ultimately, regulators need to have more than a passing familiarity with the technology they seek to oversee.

"This region has a lot of forward-looking regulators and they are spending a lot of time on [understanding] how distributed ledger technology (DLT) works," said Carl Wegner, managing director and Asia head of R3, a blockchain software enterprise firm. He said several Asian regulators had already sent staff to become certified in the subject matter.

"If you are going to regulate something, you have to understand it," Wegner said.

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