Securing the future of finance in Hong Kong

The role of Fintech in Hong Kong's global financial center

The financial crash in 2008 caused catastrophic damage to the global financial market. In the years since, financial firms have been forced to shore up portfolios and minimize risk to avoid a repeat of 2008. Substantial regulatory measures have been implemented, and bodies with regulatory oversight have been created or further empowered to make sure that financial institutions act accordingly. Integral to this reshaping of the global financial market are the global financial centers (GFC), such as London, New York and Hong Kong. These GFCs rely on a buoyant financial market, but they also need innovation to attract business and increase revenues. As such, there is hope that Fintech – the convergence of information and internet technology and finance – can provide a competitive edge to leading GFCs. American and European GFCs are already leading the way in the adoption of Fintech, particularly Blockchain, and are reaping the rewards. Hong Kong is now looking at how to boost the adoption and integration of Fintech to stay the leading GFC in Asia and the financial gatekeep for China.

A substantial issue for the adoption of Fintech is the lack of regulatory frameworks and safeguards. There is increasing confidence and a return to pre-2008 market optimism in finance; yet, there is a fear that fully embracing Fintech too soon could lead to 2008 levels of crisis. As such, GFCs such as Hong Kong are assessing the potential impact of Fintech and attempting to create a framework of regulations that will provide protection for financial firms in Hong Kong without stifling productivity and innovation. This is a delicate balancing act. The increased regulatory controls post-2008 caused significant cost increases to all financial firms. This hindered their ability to recover faster, although they were more secure from future global failures. Fintech can therefore be seen as having the potential to revolutionize and reinvigorate the global financial market in a way that has not been possible so far since the 2008 crash.

Hong Kong's role in global finance

China is the world's second largest economy (if the EU is not considered as a single economic entity). Four of the world's ten largest banks are Chinese, meaning that the GFC with access to China has the potential to challenge the dominance of London and New York. This is how Hong Kong is trying to align itself. To boost strategic innovation and development, Hong Kong has created a Financial Services Development Council, which looks to boost market development while also maintaining financial stability. The Hong Kong Monetary Authority (HKMA) has adopted a risk-based approach to policy formulation in relation to Fintech in the hopes of embracing its potential whilst minimizing the risks. As such, areas such as fraud and cybersecurity are of key focus currently in Hong Kong.

  ISSN 0258-0543 DOI 10.1108/SD-11-2017-0167

Fintech in Hong Kong

In 2010, investment in Fintech companies in the USA and UK totaled more than $24bn globally, with more than 4,000 Fintech companies in existence. These companies are seeking to disrupt the traditional financial markets by offering similar or reworked services at much faster speeds and without any of the bureaucracy and costs associated with traditional banks. While financial organizations are attempting to adopt or buy Fintech themselves, many organizations want to reduce the power and control of these traditional institutions to invigorate the market and boost innovation.

There are four types of Fintech organizations identified by Ng and Kwok (2017):

1. efficient payment process – Fintech can offer faster payments at reduced transaction costs;
2. robo-advisor – Fintech uses AI to data mine, providing unbiased and comprehensive information on any data source;
3. peer-to-peer load and deposit platform – Fintech can provide a platform for users to raise money from peers without the need for a centralized communication network, reducing costs; and
4. crowdfunding – allows businesses and individuals to access private loans for projects outside of traditional banks and typical risk evaluation frameworks.

A major risk with Fintech companies is the potential for fraud to occur. While fraud is attempted to be protected against in all industries, Fintech is so new and rapidly evolving that many gaps and areas open for exploitation are constantly being found. This makes it difficult to regulate and protect against fraud. The "Fraud Triangle" suggests that there are three factors typically leading to fraud – pressure, opportunity and rationalization. These are the same for Fintech as they are for other industries. However, two areas may be more applicable to Fintech:

1. *Excessive pressure to meet targets*: As Fintech is a new and growing industry, there is potential for firms to place overwhelming pressure on employees to perform to unrealistic levels. There is also the potential for leaders of Fintech firms to behave fraudulently in the face of an excessively competitive market to keep a semblance of a competitive edge.
2. *Untried business models and exposures to frauds*: New technology and practices in young companies can create points of weakness of which fraudsters can take advantage.

The cybersecurity focus

To deal with the potential fraudulent activity within and around Fintech companies, organizations are having to invest more heavily in cybersecurity. These need to be both internal controls and external protections. The speed at which Fintech companies operate and evolve means that there is a significant burden on the ability for cybersecurity solutions

The financial crash in 2008 caused catastrophic damage to the global financial market.

There is hope that Fintech can provide a competitive edge to leading global financial centres.

to keep up. RegTechs have been proposed to regulate fraud in Fintech, combining authentication tools such as digital certificates and biometric identification. COSO frameworks are also being adapted from more traditional forms of internal control for use in Fintech. But there is a concern that these would not be able to deal with the full integration of Fintech into the banking sector.

As such, Hong Kong and the HKMA are working hard to find solutions to both current and potential future issues regarding Fintech and fraud. They want to stay competitive and be able to adapt to new innovations in finance but not at the cost of financial stability. Cybersecurity measures are therefore at the forefront of actions to safeguard Fintech in Hong Kong, starting with the Cybersecurity Fortification Initiative and the Professional Development Program which are seeking to develop cybersecurity experts. They are also implementing the Cyber Intelligence Sharing Platform to provide infrastructure and platforms to collaborate, information share and counter any cyberattacks. These are running alongside the new Fintech Innovation Hub created by the HKMA to boost the Fintech industry in Hong Kong. All of these initiatives are designed to safeguard the GFC of Hong Kong while allowing innovation to flourish, keeping Hong Kong competitive.

Keywords:
Hong Kong,
Fraud,
Cybersecurity,
Fintech,
Risk-based approach
Global financial center

Comment

The review is based on *Emergence of Fintech and cybersecurity in a global financial centre: Strategic approach by a regulator* by Artie W. Ng and Benny K.B. Kwok, published in the Journal of Financial Regulation and Compliance.

Reference

Ng, A.W. and Kwok, B.K.B. (2017), “Emergence of fintech and cybersecurity in a global financial centre: strategic approach by a regulator”, *Journal of Financial Regulation and Compliance*, Vol. 25 No. 4, pp. 422-434.