November 2016

Hong Kong's fintech surge: HKMA grants second round of stored value facilities licences

On 4 November 2016, the Hong Kong Monetary Authority (the "**HKMA**") announced a second round of 8 successful stored value facilities ("**SVF**") licensees under the Payment Systems and Stored Value Facilities Ordinance (the "**Ordinance**"). Successful applicants in this round are 33 Financial Services, Autotoll, ePaylinks, K & R International, Optal Asia, PayPal, Transforex and UniCard Solutions.

With the issuance of the second round of SVF licenses, we now have 13 SVF licensees in Hong Kong, demonstrating the appetite for investment and growth in Hong Kong's emerging fintech ecosystem. Two licensed banks, Bank of Communications and Dah Sing Bank, are also SVF issuers, pursuant to section 8G of the Ordinance.

For our observations from the first round of SVF licensees, please **click here**.

The gate opens 13 November

The Ordinance commenced operation on 13 November 2015 with a one year transition period allowing existing SVF issuers to apply for a licence from the HKMA. From 13 November 2016 it will be unlawful for any person to issue or facilitate the issuance of an SVF in Hong Kong without a licence (or the benefit of an exemption).

What's new for the second round of SVF licensees?

A Diversity of Business Models

The players represented by the list of SVF licensees is impressive not only for its number, but also for its diversity.

The full complement of licensees now offering SVF services in Hong Kong includes technology giants such as Tencent and Paypal, incumbent telecommunications provider HKT,

Contacts

Mark Parsons
Partner, Hong Kong
mark.parsons@hoganlovells.com
+852 2840 5033

Tommy Liu
Associate, Hong Kong
tommy.liu@hoganlovells.com
+852 2840 5072

public transport fare operator Octopus and road toll system operator Autotoll. While these are all established and familiar names in the Hong Kong market, it is important to note that the successful licensees also include companies such as virtual card issuer Optal, China UnionPay card issuer K&R International, local e-wallet issuer TNG and traveller card issuer Transforex.

The clear implication is that the HKMA is encouraging a diversity of offerings in Hong Kong's fintech ecosystem, with some players directed at retail payments and stored value, others at business-to-business channels or collaboration under branded credit card schemes. Consumer choice for payment services in Hong Kong has received a significant boost, and we can expect the move to bring these players under HKMA regulation to continue to encourage wider change in Hong Kong financial services market as these licensees expand their businesses into new channels.

A Nuanced Regulatory Model

Shortly after the announcement of the first round of SVF licensees, the HKMA published a number of guidelines with which SVF licensees will be expected to comply, including:

- **Guidelines on Supervision of Stored Value Facility Licensees** (**click here**);
- **Practice Note on Supervision of Stored Value Facility Licensees** (**click here**); and
- **Guideline on Anti-Money Laundering and Counter-Terrorist Financing (For Stored Value Facility Licensees)** (**click here**).

These guidelines, and other guidance given by the HKMA during the licensing process, reflect the middle ground being sought in regulating SVF licensees to a different standard than is expected of banks. For example, the anti-money laundering and counter-terrorist financing ("AML-CTF") guideline for SVF licensees, which we discuss in more detail below, are very similar in format to the guideline for financial institutions, incorporating different transaction thresholds for customer due diligence, reflecting different assumptions about typical transaction sizes for SVFs and the role played by SVFs in Hong Kong's financial system.

Float Protection: a Key Concern

One of the challenges faced by SVF applicants completing the licensing process relates to measures required by the HKMA to ensure that stored value remains secure and available for use by SVF users. SVF licensees are required to have in place an effective and robust system to protect and manage the float and ensure that the funds are used only in accordance with SVF users' instructions, kept separate from the licensees working capital and protected against claims by the issuer's other creditors.

The specific requirements vary in each case based on the applicant's specific business model, but the HKMA has generally been requiring that a trust arrangement be put in place with a licensed bank, potentially with a bank guarantee or a custodian being appointed to monitor the flow of funds to and from a dedicated customer account holding the SVF float. The arrangements can be complex and will likely involve bespoke documentation. The HKMA has also been requiring an independent legal opinion validating the arrangements.

AML-CTF: a Model for Change?

The SVF regime has been implemented with significant focus on AML-CTF concerns. The balance being sought in the context of SVF is to enable fast and convenient payments and topping up of stored value through user-friendly digital interfaces, but at the same time recognize that an SVF could be used to facilitate payments for unlawful purposes.

As noted above, the specific AML-CTF guidelines approved for SVF licensees draw heavily from the guidelines applicable to licensed financial institutions, albeit recognising to a degree that SVF transactions are, in general, likely to be smaller in size than banking transactions. On this point, there is hope that the SVF regime will generate a regulatory experience that will turn Hong Kong's AML-CTF regulation towards the potential of technology-driven customer verification solutions. The AML-CTF guidelines for SVF, for example, point to users' utility bills as being a benchmark for verification of a residential address (as do the banks' AML-CTF guidelines). The SVF regime surely presents an opportunity to reconsider the risk-based calculations delivering the conclusion that a paper utility bill is the best available evidence of its bearer's address. The potential for biometric verification of identity, for example, has gained traction in other jurisdictions and has been recognised by regulators in Hong Kong, albeit as a supplement to paper-based methods rather than a replacement for them. In order to avoid falling further behind, Hong Kong's SVF market, rich in technological aptitude, could be leveraged as a controlled environment in which to move forward.

We would note that on 24 October 2016, the Securities and Futures Commission (the "**SFC**") issued an advisory circular concerning client identity verification in connection with account opening processes. The advisory circular acknowledges the increasingly widespread acceptance by financial services regulators of the use of biometric data, but concludes that so far this reliance has been directed at verifying instructions rather than account opening customer due diligence.

Conclusions

In his press remarks at the announcement of the second round of SVF licensees, Howard Lee, Senior Executive Director of the HKMA, commented that the implementation of the SVF supervisory regime will strengthen public confidence in the use of SVF products and services which, in turn, will facilitate development and innovation in the local retail payment industry.

The increasing array of payments options being made available to consumers in Hong Kong through the SVF regime can only be good news. Ideally, the next step in progress will be to leverage the experience gained from the SVF regime towards a more technologically-advanced financial services environment. Charting a course in this direction will enable Hong Kong to achieve its ambitions to be one of the world's leading fintech hubs.