# Regtech as Key Enabler of Market Integrity in Future of Finance

## Opening remarks at SFC Anti-Money Laundering and Counter-Financing of Terrorism Regtech Forum 2024

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Good morning, Joseph, distinguished guests, ladies and gentlemen. A warm welcome to the SFC Anti-Money Laundering and Counter-Financing of Terrorism Regtech Forum 2024. Let's call it "SFC Regtech Forum" in short.

Last week, I had the opportunity to visit Saudi Arabia for a second time this year to foster capital market connectivity. It was inspiring to engage in dialogues with our Middle East and global counterparts on the future of finance encompassing fintech, digitalisation and artificial intelligence (AI), which will be pivotal to future-proof our financial markets. I'm sure many of you also had a chance to attend the Hong Kong FinTech Week last week, where much excitement was generated over innovation, fintech, AI, tokenisation and even more.

In fact, our theme today, Regtech or regulatory technology, is also about innovation. Regtech is a major type of fintech and also accounts for the most use cases of AI-powered solutions in the financial sector so far. I believe it has a major role to play in the future of finance as an enabler of regulatory compliance, effectively helping to prevent financial crimes and safeguard investors' interests.

### Regtech progress and compliance pain points as its driver

As part of Hong Kong's continued fintech development, Regtech adoption has made exciting progress in the financial sector over the past few years. In fact, to update you all on this progress, the SFC is ready to publish our "Report on the Adoption of Regtech for Anti-Money Laundering and Counter-Financing of Terrorism" this afternoon, to highlight use cases and help financial firms further adopt Regtech. I thank those of you who have helped us in this survey, and encourage you all to read the report.

Perhaps you can't wait, so I'm giving you a preview. Overall, our findings are highly encouraging: Hong Kong's Regtech adoption has advanced in major anti-money laundering, or AML, processes over the past three years. Among the 50 firms surveyed, more than 80% confirmed their AML ability has improved, thanks to Regtech.

A majority of the firms have implemented Regtech solutions in at least one key process. The adoption rate was as high as 92% for name screening, followed by about 70% for both customer due diligence and transaction monitoring. In general, Regtech has covered more AML processes, and more advanced technologies are deployed.

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Note: This is the text of the speech as drafted, which may differ from the delivered version.

These data represent a remarkable improvement and upskilling since our last survey in 2021. Three years ago, only about half of the surveyed firms reported using technologies in AML processes, and the conventional methods employed were a far cry from the Regtech we have today. This fresh momentum reflects more firms are pursuing better ways to address the growing scale and sophistication of financial crimes in recent years.

Moreover, it is clear to us that conventional AML approaches are losing efficacy, because bad actors constantly try to get the better of us through novel techniques to launder crime proceeds. This issue is especially acute for firms dealing with an increasing volume of customer and transaction data. As a result, firms often expose themselves to unnecessary risks that could have been avoided with effective Regtech tools.

Furthermore, we have found in our inspections that many firms struggle with a daunting backlog of pending reviews. This is due to a high volume of false positive alerts from name screening and transaction monitoring. Resource constraints usually keep firms from paying timely attention to these alerts, and delays range from six months to over a year.

False alerts in transaction monitoring typically arise from traditional rule-based solutions. These solutions are only as good as a one-trick pony, given their ability to consider only one single static parameter, such as large transaction amounts or frequent transactions. Without the benefit of dynamic parameters, such as a customer's profile and usual transaction patterns, these solutions often flag legitimate transactions as suspicious. That leads to many futile investigations, operational inefficiencies, higher compliance costs, and sometimes regulatory consequences when obvious red flags are missed.

**Regtech use cases burgeoning**

This is where Regtech comes in, providing an agile and effective tool to mitigate the evolving risks linked to financial crimes. Regtech solutions can significantly ease financial firms' burden to perform labour-intensive tasks through automation, data analytics and AI. They can also swiftly process a sea of data and enable firms to focus attention on suspicious activities.

Let me share a few major use cases to show you how financial firms increasingly adopt Regtech throughout the AML processes.

(i) Client onboarding

The first use case is client onboarding. Firms onboarding clients online now adopt Regtech to authenticate their identity and also collect digitised customer data for subsequent AML processes. This does not only assist firms in regulatory compliance, but also enhances customer experience by streamlining the onboarding process.

A notable example is authenticating identity through the "iAM Smart" application. With a massive registered user base of more than three million, this recognised digital identification system can be connected via application programming interface (API) with account opening applications, so many firms consider it a cost-effective way to meet customer due diligence requirements. Its "e-ME" form filling function also sharply quickens the account opening process, while ensuring customer information is accurate and reliable.

(ii) Name screening

Next is the very common use case of name screening. It has the highest Regtech adoption rate of 92%, clearly because many firms are “drowning” in the numerous false alerts from their systems.

For name screening, robotic process automation, or RPA, is commonly deployed as a simple and affordable way to extract relevant customer information and compare it against the system alerts. An RPA bot can also be programmed to ingest an individual’s identification information, such as date of birth, age, gender and country of residence. It can save a good amount of manpower by closing those alerts with clear identity mismatches.

In addition, the natural language processing, or NLP, engine is another screening tool that can extract names and keywords from news articles for adverse media monitoring. It provides much convenience by concisely summarising similar news articles across languages, thus preventing duplicate alerts and minimising manual review efforts.

(iii) Transaction monitoring

A third use case involves transaction monitoring, which is an important process to detect unusual or suspicious transactions and activities. Its high Regtech adoption rate of 69% proves the tremendous capabilities of technological solutions in helping to monitor transactions.

We understand some firms are now gradually migrating from traditional solutions to more advanced ones to address the issue of false alerts. For example, one of the transaction monitoring solutions can generate alerts based on customised scenarios. Its AI-powered alert scoring engine can quickly determine a risk score for the alerts. The underlying machine learning model of this engine is trained to identify red flags and learn from historical assessment behaviours and decisions. This allows firms to separate wheat from chaff and sharply raise efficiency by prioritising resources for higher-risk alerts.

(iv) Third-party deposit identification and due diligence

Now, the fourth use case, which is third-party deposit identification and due diligence. It may have a modest Regtech adoption rate at 34% but the reason for this is understandable, because the relevant requirements were introduced only in 2019 and they are unique to the securities sector. However, this has highly promising potential in improving operational efficiency and customer experience.

To help firms promptly identify the source of deposits, it is a common use case to establish an API connection with banks to retrieve information about incoming funds into a firm’s bank accounts. This automatic retrieval can be done every half hour, and the information includes depositors’ names and deposit amounts. Meanwhile, a name-matching tool compares these names against those in the firm’s customer database. Only if the names match will the funds go through to the customer’s trading account.

This approach helps promptly identify deposits as either customer or third-party funds. Customers can also be spared the trouble to provide bank-in slips or cheque copies to prove their source of deposits.

## Responsible adoption is key

After sharing with you four compelling use cases, I hope we are all on the same page that Regtech adoption empowers financial firms in their AML risk management. In the meantime, I must emphasise it is crucial to adopt Regtech responsibly, through the effective governance, proper oversight and full accountability of senior management. Similar to other AML controls, the responsibility falls on our licensed firms to regularly review all Regtech solutions including AI models, and safeguard the vast body of customer and transaction data with robust data protection and cybersecurity measures.

The SFC firmly believes the responsible use of innovative technologies can future-proof our financial markets, and we are about to set out our expectations on the intermediaries regarding their adoption of generative AI language models in providing financial services. So stay tuned.

## Closing remarks

Ladies and gentlemen, there is an obvious reason why you still cannot find the word “Regtech” in major dictionaries. It actually took years for “fintech” to be widely adopted, both as a word and a revolutionary technology. This transition often signifies a new phase of development. And driving this progress for Regtech is the very purpose of our forum today.

By taking a gradual approach based on your needs, priorities and capacities, I am confident that your business can thrive on responsible Regtech adoption. It is more affordable than you think, especially compared to the heavy cost of overlooking money laundering risks. By following the Regtech adoption roadmap, we can make compliance more efficient and effective, which is sure to strengthen the integrity of our financial system.

I hope you all enjoy this forum. Thank you.