

Press Release

LCQ16: Policy of Hong Kong Monetary Authority on virtual banks

Wednesday, December 13, 2017

Following is a question by the Hon Chan Chun-ying and a written reply by the Secretary for Financial Services and the Treasury, Mr James Lau, in the Legislative Council today (December 13):

Question:

In 2000, the Hong Kong Monetary Authority (HKMA) issued a Guideline on the Authorisation of Virtual Banks (the Guideline (2000 edition)), stating that HKMA would "not object to the establishment of virtual banks in Hong Kong" provided that such virtual banks could satisfy the same prudential criteria applicable to conventional banks. However, HKMA announced in September this year the initiatives for preparing Hong Kong to move into a new era of smart banking, one of which was the "promotion of virtual banking" in which HKMA clearly stated that it "welcomes the introduction of virtual banks in Hong Kong" and it would consult the banking industry to review and amend the Guideline (2000 edition). In this connection, will the Government inform this Council:

(1) of the respective numbers of applications for operating virtual banks received and approved by HKMA in the 17 years since the Guideline (2000 edition) was issued; the business scale, service categories and cost-effectiveness of the virtual banks permitted to operate and, among such banks, the number of those which are still operating at present;

(2) of the considerations based on which HKMA changed its stance on the establishment of virtual banks in Hong Kong from no-objection in 2000 to welcoming it in September this year; whether HKMA had consulted members of the banking industry before changing its stance; if HKMA had, of the details and the views received; if not, the reasons for that;

(3) given that a webpage on "Guide to Authorization" (last revised on November 18, 2016) on HKMA's website can be hyperlinked to a document entitled Guideline on Authorisation of Virtual Banks (the Guideline (newer edition)), and paragraph 2 of that document states that the Guideline (newer

edition) supersedes the Guideline (2000 edition), of the reasons why HKMA still indicated in September this year that it would consult the banking industry to review and amend the Guideline (2000 edition); and

(4) given that one of the conditions for institutions incorporated overseas to apply for the establishment of virtual banks, as prescribed in Guideline (2000 edition), was that such institutions had to have a total assets of more than US\$16 billion, whereas the Guideline (newer edition) only requires such institutions to maintain a minimum level of share capital of HK\$300 million, whether HKMA had consulted members of the banking industry before it decided to significantly reduce the capital requirement for virtual banks; if so, of the details and the views received; if not, the reasons for that?

Reply:

President,

There is only one type of banking licence under the Banking Ordinance (the Ordinance). In other words, the authorisation criteria for virtual banks and conventional banks are the same. Institutions that meet the financial and prudential requirements as stipulated in the Ordinance may apply for a banking licence from the Hong Kong Monetary Authority (HKMA), irrespective of whether they plan to operate as a virtual bank or a conventional bank. Nevertheless, the HKMA issued the "Guideline on Authorisation of Virtual Banks" (the Guideline) in 2000, in view of the different operating models of virtual banks and conventional banks. The Guideline aimed at clarifying how the authorisation criteria under the Ordinance would be applied in the context of virtual banks. Subsequently, the Guideline was included as a chapter in the "Guide to Authorization" (the Guide), which sets out the HKMA's policies on authorisation regarding the banking sector as a whole.

Following consultation with the banking industry, the HKMA modified in 2012 the market entry criteria of the banking sector, including removing the relevant requirements relating to the size of customer deposits and total assets. After the Legislative Council's approval of the relevant amendments to the Ordinance, the HKMA amended the Guide and made corresponding changes to the Guideline. However, no change was made to the Guideline with respect to how the authorisation criteria would be applied in the context of virtual banks.

The HKMA continues to refer to the principles stipulated in the Guideline when processing applications of banking licences for carrying out virtual banking business.

Since the issuance of the Guideline in 2000, a number of institutions authorised under the Banking Ordinance (authorised institutions) have approached the HKMA to explore the transformation of their original business models to business models similar to virtual banks, focusing on the provision of retail banking services. One licensed bank did implement such transformation although the bank later ceased adopting such a business model subsequently, due to commercial considerations. As regards other institutions that have applied for new banking licences from the HKMA, none of them involve the operation of virtual banking business.

When the Guideline was issued in 2000 during the dot-com euphoria, many companies raised the idea of establishing virtual banks. As operating the business model of virtual banks was a relatively new concept, the HKMA took a more prudent stance at that time by not objecting to the establishment of virtual banks in Hong Kong as long as the banks would be able to meet the prevailing authorisation criteria. With the rapid development of fintech in recent years, overseas experiences indicate that it has become commercially and technically more sophisticated for virtual banks to operate without any physical branch. As virtual banks would be conducive to fintech development and would enhance customer experience and financial inclusion, the HKMA announced in September this year that it would review the principles stipulated in the Guideline regarding the processing of virtual banking authorisation applications, with a view to introducing virtual banks in Hong Kong. This will offer more choices to the public and facilitate Hong Kong to embrace the technological innovations in the financial sector.

As both virtual banks and conventional banks involve solicitation of deposits from the public, institutions that intend to set up virtual banks must be financially sound and have put in place adequate risk management systems in order to protect the interests of depositors. The HKMA does not intend to amend the existing authorisation criteria under the Ordinance. However, the Guideline will be amended in the light of the characteristics and risks specific to virtual banks so that applicants of banking licences for operating virtual banks would better understand how the authorisation criteria will be applied in

the context of virtual banks. The banking and technology sectors would be consulted during the review process.

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