FINTECH ASSOCIATION OF HONG KONG

Public Consultation on "Guideline on Authorization of Virtual Banks" – FTAHK response, March 2018

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The FinTech Association of Hong Kong (FTAHK) is a **member-driven, independent, not-for-profit, and diverse** organisation that is the voice of the FinTech community in Hong Kong. It is organised and led by the community, for the community through a series of committees.

Our objective is to promote Advocacy, Collaboration and Education in the wider FinTech ecosystem.

Build the community.

Be the connector.

FOREWORD

FTAHK welcomes the HKMA's proposed revision of the "Guideline on Authorization of Virtual Banks", a key deliverable within its New Era of Smart Banking Initiatives.

The FinTech Association of Hong Kong ("FTAHK") welcomes the Hong Kong Monetary Authority's ("HKMA"'s) *New Era of Smart Banking Initiatives* announcement made on 29 September 2017, and re-enforced during HKMA FinTech Day, 23 October 2017, during Hong Kong's flagship "FinTech Week".

The HKMA plans to implement multiple initiatives to support innovation in the banking sector and embrace the opportunities brought about by the convergence of financial services and technology. This response focuses on the initiative to revise the "Guideline on Authorization of Virtual Banks" first published in 2000, and subsequently revised in 2012, in line with corresponding revisions to the Banking Ordinance.

FTAHK recognises that there is only one type of full "licensed bank" licence under the Banking 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. FTAHK understands that the guideline is aimed at clarifying how the authorisation criteria under the Ordinance would be applied in the context of characteristics and risks specific to virtual banks.

FTAHK strongly believes that Hong Kong is at a tipping point whereby a convergence of factors is enabling the emergence of new and improved financial services. Such factors include:

- A quest to upgrade local offerings, functionality and customer experiences;
- Greater connectivity between banks, payment service providers and other ecosystem players including FinTech startups and content providers;
- Greater connectivity with mainland and wider Asia-Pacific e-commerce and payment experiences;
- Greater access, transparency and flexibility of individuals' financial data.

If well-orchestrated, there is the opportunity to protect Hong Kong's long-term relevance as a leading financial hub and sustainably position the city as a leading FinTech hub. FTAHK is uniquely positioned in Hong Kong in its comprehensive representation of the FinTech sector and singular focus on the same. Members include Authorised Institutions, FinTech startups, technology firms, law firms, professional services and academic institutions. To this end, we intend to provide an objective response to the proposed revisions, comprising a balanced view from Hong Kong's diverse ecosystem participants.

FEEDBACK AND GENERAL COMMENTS

FOCUS ON RETAIL BANKING
cf. para. 1,3,6

- We would encourage the HKMA to seek greater collaboration amongst Hong Kong's regulators with a view to assessing the benefits of virtual banking outside of the retail banking sector. For example, in 2017 the UK saw the launch of ClearBank, the UK's first clearing banking in over 250 years. Hong Kong has great, historical strengths in Capital Markets and Trade Finance which would benefit from a similar review of licensing eligibility and permitted modes of operations.
- The emergence of ecosystem driven business models, further supported by the rise of Open APIs, is only going to increase demand for a joined-up view of regulation. This is likely to become a differentiating factor for global FinTech hubs.

FOCUS ON FINANCIAL INCLUSION
cf. paras. 3,6

- The revised guideline states that virtual banks should "play an active role in promoting financial inclusion" and "endeavour to take care of the needs of their target customers". Financial inclusion contributes to an overall robust financial infrastructure, which in turn facilitates economic growth. FTAHK welcomes the attention paid to financial inclusion and encourages Hong Kong's banks to deliver maximum value for society at large. This is a mandate that should not be restricted to virtual banks alone.
- As they stand, the revised guideline is unclear as to whether it is placing a specific financial inclusion requirement on virtual banks in a manner which is not expected of existing conventional banks. If the inclusion requirement is concrete and quantifiable then we would welcome further clarity as to how this should be called out within the applicant's business plan as well as what steps will be taken to ensure applicants are not placed at a competitive disadvantage vis-à-vis conventional banks.
- The revised guideline states that virtual banks "should not impose any minimum account balance requirement or low-balance fees on their customers". Conventional banks often impose such requirements or fees on their customers so it is unclear why the HKMA would wish to restrict the commercial models available to virtual banks, particularly in the light of para. 19 which states that "*the MA will not interfere with the commercial decisions of individual institutions*".

OWNERSHIP OF A VIRTUAL BANK
cf. paras. 8,9,10

- Firms with > 50% ownership by an eligible financial institution are those least impacted by the revised guidelines. However it is our view that the revisions actually increase the barrier to entry for new applicants of this type given the potential additional burden of financial inclusion, corporate governance, risk management and commercial model restrictions raised elsewhere. We would like to see the HKMA more concretely encourage the establishment of virtual banks by existing financial institutions to support sustainable competition amongst new and existing market participants.

- Firms with > 50% ownership by non-financial institutions are the primary beneficiaries of the revised guidelines. We would welcome further clarity regarding the "other information" which may be required as part of the supervisory conditions to which the applicant's locally incorporated holding company will be subject.
- Finally, we would also welcome clarity on how newly incorporated, Hong Kong headquartered firms *without majority ownership* would be treated when applying for licensing as a virtual bank.

PHYSICAL PRESENCE
cf. paras. 12,13

- We understand the need for a locally incorporated company to maintain a physical address and offices. However, requiring the office to "*enable customers to make enquiries or complaints in person and allowing the customer to verify the identity of its customers where necessary*" is not in keeping with the concept of virtual banking. It is our view that virtual banks should put robust customer enquiry processes in place and demonstrate their viability, agnostic of the chosen channel. Requiring a physical safeguard for customer interaction and verification is building in legacy requirements which unnecessarily limit the potential for remote, robust alternatives.
- Regarding the requirement to "*keep a full set of their books, accounts and records of transactions in Hong Kong*" presumably the modern day interpretation of this requirement is that rather than a physical copy, these must held on accessible Hong Kong based servers, which would become a necessary consideration for banks building on the cloud.
- Similarly, in relation to regulatory reporting the HKMA should expect that virtual banks will be managing their risk and reporting requirements by taking advantage of advances and efficiencies in data analytics (RegTech).

OUTSOURCING
cf. para. 23

- It is our view that the majority of new build banks will make extensive use of third-party infrastructure (including cloud service providers, fixed and mobile telecommunication networks). We understand that virtual banks will be subject to the SPM module SA-2 on "Outsourcing". However, the HKMA should clarify the extent to which it is comfortable with extensive reliance on cloud-based technology, and will not consider such an arrangement as "hindering power of control over an institution" (c.f. the Ordinance, section 52) in addition to ensuring the HKMA's readiness to treat mainstream providers of cloud services as a normal platform option for virtual banks.

CAPITAL REQUIREMENTS
cf. para. 24

- We would welcome clarity as to the extent to which both the holding company and virtual bank applicant should be capitalised in aggregate. In the spirit of lowering the barrier of entry for new market entrants, we would point to the UK where the Prudential Regulation Authority (PRA) reduced capital and prudential requirements to reflect the reduced exposure to risk presented by smaller, targeted banks.
- There is precedent in Hong Kong when a special purpose version of the Deposit-taking Company licence was created to enable the authorisation of the issue of multi-purpose stored value cards. Characteristics included the lower minimum

capital requirements of HKD 25m and a waiver on restrictions relating to minimum deposit amounts and minimum term of maturity. New requirements were added that were fit-for-purpose for issuers such as Octopus.

CONCLUDING COMMENTS

- The HKMA's stance on virtual banks changed in para.3 from one of no-objection to instead actively welcoming their establishment. To that end, we would like to see further encouragement for the establishment of virtual banks. Whilst we agree that the risks presented by a primarily online model will necessarily be different to those of a branch-first model we are of the view that the revised guideline should ensure a level playing field between existing players and new market entrants.
- The revised guideline does not make specific provisions for incoming, complementary initiatives such as remote onboarding, Open APIs, access to a shared eKYC utility etc. It is our assumption that all licensed banks will have equal and fair opportunity to access such services as and when they become available.
- As the revised guideline stands, the licensing requirements for a virtual bank appear to be more stringent than for those of a conventional bank. As Hong Kong's existing retail banks trend towards the majority of their customer interactions occurring over digital channels we would expect these same virtual banking requirements to be applied across the retail banking sector at large. These should be complemented by scalable risk controls adapted to the size of customer base, product complexity and scope of services being provided.

The FTAHK thanks the HKMA for inviting broad and representative participation and looks forward to continued involvement in shaping the future of our collective banking and wider financial services industry.

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