

CHAPTER 9

AUTHORIZATION OF VIRTUAL BANKS

(Revisions to the Guideline on Authorization of Virtual Banks are currently under public consultation. This Chapter will be updated in due course.)

Introduction

- 9.1 The MA, pursuant to section 16(10) of the Ordinance, has issued a “[Guideline on Authorization of Virtual Banks](#)” (the Guideline) which sets out the principles which the MA will take into account in deciding whether to authorize “virtual banks” applying to conduct banking business in Hong Kong.¹ The Guideline is subject to periodic review. This Chapter reproduces the contents of the latest version of the Guideline, but may also incorporate updated information such as changes in certain regulatory guidelines that may not yet have been included in the Guideline.
- 9.2 A “virtual bank” is defined as a company which delivers banking services primarily, if not entirely, through the internet or other electronic delivery channels. It does not refer to a licensed bank which makes use of the internet or other electronic means as an alternative channel to deliver its products or services to customers.

General principles

- 9.3 The MA will not object to the establishment of virtual banks in Hong Kong provided that they can satisfy the same prudential criteria as described earlier in this Guide that apply to conventional banks. In considering whether to approve or refuse an application for authorization, the MA needs to be satisfied that the minimum criteria for authorization in the [Seventh Schedule](#) to the Ordinance are met. Reference should be made to Chapter 4 for details about the manner in which the MA will interpret these licensing criteria.
- 9.4 For a company applying to set up a virtual bank (virtual bank applicant), fulfilment of the minimum criteria essentially means that it must have substance and cannot simply be a “concept”, taking advantage of the popularity of the internet. It must also have a detailed business plan setting out how it intends to conduct its business and how it proposes to comply with the authorization criteria on an ongoing basis.

¹ This Chapter does not address the use of overseas websites by overseas entities to solicit deposits from members of the public in Hong Kong. As mentioned in paragraph 2.6, provided that the deposits were placed overseas the entity concerned would not be taking deposits in Hong Kong and would not be required to be authorized under the Ordinance. However, section 92 of the Ordinance makes it an offence for any person to issue any advertisements, invitations or documents (advertising materials) to members of the public in Hong Kong to make a deposit, even if it is made outside Hong Kong, unless the disclosure requirements in the [Fifth Schedule](#) to the Ordinance are complied with. The factors that the MA will take into account in considering whether advertising material for deposits issued over the internet or other technological means is targeted at members of the public in Hong Kong are set out in the Supervisory Policy Manual (SPM) module [TM-E-2](#) “Regulation of advertising material for deposits issued over the internet”.

- 9.5 Although technology risk will be a major factor to be taken into account by a virtual bank, the applicant should attach equal importance to the management of conventional banking risks such as credit, liquidity and interest rate risk. In addition, the MA must be satisfied that the controllers, directors and chief executives of the applicant are fit and proper persons.

Physical presence

- 9.6 A virtual bank applicant, if authorized, must maintain a physical presence in Hong Kong, which will be its principal place of business here. This is necessary to provide a point of contact with the bank in Hong Kong for both customers and the MA. For example, such an office will enable customers to make enquiries or complaints and allow the bank to verify the identity of its customers.
- 9.7 A virtual bank can establish one or more local branches to supplement its cyber network provided that approval under section 44 of the Ordinance has been obtained from the MA. It may also maintain one or more local offices provided that the notification requirement under section 45A of the Ordinance is complied with. To facilitate examination and inspection by the MA pursuant to section 55 of the Ordinance, a virtual bank must keep a full set of its books, accounts and records of transactions in Hong Kong.

Information technology (IT) security of virtual bank

- 9.8 IT security is of vital importance to a virtual bank. Security breaches and unauthorized tampering with the systems of the bank could result in financial loss as well as loss of reputation. The general principle is that the security controls in place should be “fit for purpose”, i.e. appropriate to the type of transactions which the virtual bank intends to carry out.
- 9.9 In this connection, a virtual bank applicant will be required to commission an independent assessment report on the security of its computer hardware, systems, procedures and controls from a qualified and independent expert. A copy of this report should be provided to the MA as part of the documents submitted on application. The bank should also establish procedures for regular review of its security arrangements to ensure that such arrangements remain appropriate having regard to the continuing developments in IT security technology.

Risk management

- 9.10 Like conventional banks, a virtual bank applicant must understand the types of risk to which it is exposed and put in place appropriate systems to identify, measure, monitor and control these risks. It should be aware that certain types of risk (e.g. liquidity, operational, reputation risk) may be accentuated in the case of virtual banks because of their nature of operation.

- 9.11 At a minimum, the applicant must go through the eight basic types of risk identified in the risk-based supervisory framework of the MA (i.e. credit, interest rate, market, liquidity, operational, reputation, legal and strategic risk), analyse to what extent it will be subject to these risks as a virtual bank and establish appropriate controls to manage these risks.

Business plan

- 9.12 A virtual bank must be able to present a business plan which strikes an appropriate balance between the desire to build market share and the need to earn a reasonable return on assets and equity.
- 9.13 While the MA will not interfere with the commercial decisions of individual institutions, he would be concerned if a virtual bank planned to aggressively build market share at the expense of recording substantial losses in the initial years of operation. Such tactics could be detrimental to the stability of the banking sector and could undermine the confidence of the general public in the bank itself. In any case, a virtual bank should not allow rapid business expansion to put undue strains on its systems and risk management capability.

Terms and conditions of service

- 9.14 A virtual bank should observe the standards contained in the Code of Banking Practice issued by the Hong Kong Association of Banks and the DTC Association. It must set out clearly in its terms and conditions what are the respective rights and obligations between the bank and its customers. Such terms and conditions should be fair and balanced to both the bank and its customers. Customers must be made aware of their responsibilities to maintain security in the use of virtual banking services and their potential liability if they do not. In particular, the terms and conditions should highlight how any losses from security breaches, systems failure or human error will be apportioned between the bank and its customers.
- 9.15 In this regard, the MA's view is that unless a customer acts fraudulently or with gross negligence such as failing to properly safeguard his device(s) or secret code(s) for accessing the e-banking service, he should not be responsible for any direct loss suffered by him as a result of unauthorized transactions conducted through his account.

Outsourcing

- 9.16 The MA does not object in principle to outsourcing of computer operations of a virtual bank to a third party service provider. Virtual banks should discuss their plans for outsourcing with the MA in advance. They should demonstrate that the principles in the SPM module on "Outsourcing" ([SA-2](#)) will be complied with. In particular, the MA must be satisfied that the computer operation outsourced remains subject to adequate security controls, that confidentiality and integrity of customer information will not be compromised and that the requirements under the Personal Data (Privacy) Ordinance and common law customer confidentiality are complied with. The MA must have the right to carry out inspections of the security arrangements and other controls in place in the service provider or to obtain reports from a relevant

supervisory authority, external auditors or other experts. The MA must also be satisfied that his powers and duties under the Ordinance (in particular, section 52 relating to the power of control over an institution) will not be hindered by the outsourcing arrangements.

Principles applicable to virtual banks incorporated in Hong Kong

Ownership structure

- 9.17 A virtual bank incorporated in Hong Kong should be at least 50% owned by a well established bank or other supervised financial institution in good standing in the financial community and with appropriate experience. This is in keeping with the long-standing general policy of the MA that a person who intends to hold 50% or more of the share capital of an authorized institution incorporated in Hong Kong should be a well established bank (or equivalent institution)². Where a bank enters into a 50-50 joint venture with a non-bank, the bank (or equivalent institution) should have the right to appoint the chairman of the virtual bank and the chairman should have a casting vote.
- 9.18 The ownership of virtual banks is particularly important because they are usually new ventures which could be subject to higher risks in the initial years of operation and it is essential that there should be a strong parent behind to provide guidance and financial support. In this regard, the parent bank (or equivalent institution) should undertake to provide additional capital and/or liquidity support when such a need arises. The MA would also expect the parent bank (or equivalent institution) to play an active role in overseeing the business and affairs of the virtual bank through its participation in the board of directors.

Principles applicable to virtual banks incorporated outside Hong Kong

Adequacy of home supervision

- 9.19 A virtual bank incorporated outside Hong Kong which wishes to establish itself in Hong Kong in branch form must come from a country where there is an established regulatory framework for electronic banking.
- 9.20 This requirement follows from Paragraph 2 of the [Seventh Schedule](#) which specifies that an applicant incorporated outside Hong Kong must be a bank which, in the opinion of the MA, is adequately supervised by the relevant banking supervisory authority (usually the home supervisor in the place where the applicant is incorporated). In assessing the adequacy of the regulatory framework for electronic banking in the home country, the MA will take into account the extent to which the home supervisor's standards and practices are comparable to those of the MA.

² An existing well established bank holding company may be regarded as falling within this category.

Capital requirement

- 9.21 Virtual banks are required to maintain minimum levels of share capital of HK\$300 million (including paid-up share capital and balance of share premium account). In respect of virtual banks incorporated outside Hong Kong, the requirement applies to the institution as a whole.