HONG KONG MONETARY AUTHORITY
香港金融管理局

Consultation Conclusions on

Review of the Three-Tier Banking System

5 August 2024

Contents

I. Introduction

1. The Hong Kong Monetary Authority (HKMA) issued a consultation paper on 26 June 2023 on its proposal to simplify the current three-tier banking system, which comprises licensed banks (LBs), restricted licence banks (RLBs) and deposit-taking companies (DTCs), into two tiers by merging DTCs into the RLB sector, thereby forming a new second-tier of our banking system ("Consultation Paper").

2. The three-month consultation ended on 25 September 2023. A total of 7 submissions were received from various parties including industry associations, Authorized Institutions, professional associations, a statutory body and a chamber of commerce. The names of the respondents are listed in the Annex.

3. Having also analysed additional information collected from DTCs, the HKMA is putting forward some suggested new parameters of the proposal as set out in this paper with a view to addressing the comments raised in the consultation.

4. This consultation conclusions paper ("Conclusions Paper") summarises key comments received from the respondents to the Consultation Paper, the responses of the HKMA to those comments, and the HKMA's proposal on implementing the new two-tier banking system. This Conclusions Paper should be read together with the Consultation Paper.

II. Executive Summary

5. The respondents expressed broad support for the proposal of the Hong Kong Monetary Authority (HKMA) to simplify the three-tier banking system into two tiers, thereby enhancing the industry's role in strengthening Hong Kong's status as an international financial centre. They also provided comments on certain practical and implementation aspects, and sought clarifications on several areas. Highlighted below are some of the key comments received during the consultation and the HKMA's responses.

Transition period

6. In response to questions and comments on the transition into the new second-tier, the HKMA intends to adopt an arrangement for existing deposit-taking companies (DTCs) whereby they will be converted to be a restricted licence bank (RLB) upon demonstrating to the satisfaction of the HKMA that they have met the minimum capital requirement of an RLB (i.e. HK$100 million) before the end of the 5-year transition period. It follows that DTCs that wish to upgrade to the new second-tier will not be required to submit fresh licence applications for the upgrade to the HKMA. For DTCs that do not upgrade to become an RLB or a licensed bank (LB) before the end of the 5-year transition period, they will be deemed to have requested the Monetary Authority (MA) to revoke its authorization as a DTC.

Minimum requirements on deposit-taking activities

7. Some respondents expressed concern about the minimum deposit size requirement of the new second-tier, and suggested lowering the requirement to somewhere in the middle between HK$500,000 and HK$100,000 to prevent potential loss of existing depositors of DTCs and provide broader public access to deposit services. Taking their comments into consideration, it is intended that flexibility will be given to the existing depositors of DTCs in meeting the new minimum deposit size requirement with a view to minimising the impact on them. In gist, a deposit taken by a DTC before its upgrade to an RLB of less than HK$500,000 may continue up to the end of the 5-year transition period subject to the pre-existing deposit size requirement of HK$100,000 and 3-month maturity restriction.

Impact on banking stability

8. In general, the respondents agreed that the proposed simplification should not have significant impact on banking stability. A few other respondents shared comments on possible impact on the existing DTCs and customers. In light of these comments, the HKMA has conducted a more detailed analysis on the DTC sector as set out in this Conclusions Paper.

III. Comments and Conclusions

Simplification into a two-tier system

Question 1:	Do you agree that the three-tier banking system should be simplified into two tiers by merging DTCs into RLBs?

Comments received

9. The respondents were generally supportive of the proposed simplification, considering the decreasing number of deposit-taking companies (DTCs), the limited differences between the DTC and the restricted licence bank (RLB) sectors, and the potential merits of the proposed simplification (including enhanced regulatory efficiency, industry competitiveness as well as customer protection), which could further enhance the banking industry's role in strengthening Hong Kong's position as an international financial centre.

10. A respondent suggested that, while simplification from three-tier to two-tier might be an acceptable and pragmatic approach based on the current conditions, consideration should be given to simplifying the structure into a one-tier banking system that comprises licensed banks (LBs) only, lowering the minimum capital requirement of LBs to HK$100 million as capital adequacy ratio is the primary measure relied upon by stakeholders, and imposing restrictions on smaller banks' deposit-taking activities through appropriate licensing conditions (e.g. limiting the portion of deposits not covered by the Deposit Protection Scheme (DPS), a pre-set ratio of total outstanding deposits to capital base, etc.). It commented that a tiered licensing regime no longer played a meaningful role in achieving the policy objectives of the Hong Kong Monetary Authority (HKMA) in present day circumstances, and that a one-tier banking system would render it easier for the HKMA to allocate its supervisory resources according to the risk profile of individual Authorized Institutions.

11. A respondent suggested that the HKMA should in the future consider further reforms to further disambiguate LBs from the new second-tier institutions.

HKMA's response

12. The HKMA noted the suggestion for a one-tier structure from a respondent. The HKMA maintains its view that a tiered system is useful for distinguishing banks qualified to accept retail deposits from institutions that should be restricted in the types of deposits they can take for prudential and depositor

protection considerations. Other banking centres also adopt a tiered approach, with categorisation of different types of deposit-taking institutions reflecting their different types of business activities. A tiered system also offers flexible means of entry into the banking industry. Unlike the DTC sector, there is still interest in the RLB sector, with 7 RLB licence applications approved between 2009 and 2023. Furthermore, lowering the minimum capital requirement of LBs to HK$100 million is not considered conducive to maintaining stability of the banking system.

13. Simplifying the three-tier structure into one-tier might have significant ramifications for the banking industry. For instance, the already keen competition in the retail banking market would be intensified if locally incorporated RLBs and DTCs were allowed to conduct retail banking business after upgrading to become LBs.

14. The HKMA considers that there is clear distinction between LBs and the second-tier institutions under the new framework. Only LBs are not subject to the restriction on the size of deposits taken and can carry on banking business as defined in the Banking Ordinance (BO). The new second-tier institutions will be subject to minimum deposit size and capital requirements at the existing levels applicable to RLBs whereas the restriction that RLBs should not operate checking accounts or savings accounts will remain a principal distinction between LBs and the new second-tier institutions.

Transition period

Question 2:	Do you have any comments on the proposed transition period of 5 years for existing DTCs to upgrade to the second-tier (i.e. RLBs) or LBs, or transforming themselves into other types of regulated financial entities depending on their business models and revoking their registration as DTCs voluntarily?

Comments received

15. A respondent commented that a 5-year period would be too long for what was essentially an administrative exercise to address potential uncertainties of the stakeholders of DTCs. On the other hand, another respondent commented that it would be more appropriate to have a transition period of 8 years to allow sufficient time for DTCs to build new business, acquire the necessary key manpower, and strengthen internal control systems and technology. Other respondents expressed general agreement that the duration of 5 years for the transition period would be appropriate.

16. A respondent preferred grandfathering of its DTC registration and of the registration and approvals under the securities regime for both the institution,

and its executive officers and staff, as it did not have depositors and could already meet the minimum capital requirement of the new second-tier.

17. Some respondents sought clarifications on the transitional arrangements, including option for grandfathering, application process for licence upgrade, re-appointment of existing managers and directors, and transformation to other types of regulated financial institutions.

18. A respondent commented that appropriate measures should be put in place to ensure a smooth transition for all relevant financial institutions and their customers. For example, offering assistance to DTCs in licence applications to facilitate their transformation, providing sufficient guidance to DTCs to ensure that the rights and wills of their existing customers would be taken into account during the transition process. The respondent also noted that customers should not suffer any financial loss as a result of a DTC's change in licence status and that they should be notified of the change well in advance. Finally, this respondent also suggested that there should be appropriate publicity and education campaigns to provide adequate information to customers so as to enable customers to make informed choices in the course of the transition.

HKMA's response

19. Taking into account the respondents' feedback, further thoughts have been given on the transitional arrangements with a view to facilitating the transition of a DTC to become an RLB and to minimising disruption to existing customers of the DTC. Since the authorization criteria are basically the same across DTCs and RLBs except for the minimum capital requirement, the HKMA is inclined to adopt an arrangement to streamline the transition of DTCs into RLBs that is similar to the one used in 1990, where the categories of Licensed Deposit-Taking Company and Registered Deposit-Taking Company were replaced by the current RLB and DTC respectively. Set out below are key parameters of the intended arrangement:

    (a) any existing DTC that wishes to upgrade to an RLB during the 5-year transition period will be converted to be an RLB ("Converted RLB") upon the date (the "Designated Date") when it can demonstrate to the satisfaction of the HKMA (e.g. by the production of an auditor's certificate) that the aggregate amount of its paid-up share capital and the balance of its share-premium account (if any) is not less than HK$100 million or an equivalent amount in any other approved currency. This means that:

        (i) no fresh licence application is required to be submitted by the DTC to the HKMA for upgrading to become an RLB. Any conditions previously attached by the Monetary Authority (MA) to the institution's authorization as a DTC shall be carried over to the institution's new status as an RLB. Likewise, any act that has been done under Part X of the BO in relation to a DTC before the

Designated Date shall be deemed to have been done in relation to the Converted RLB;

(ii) the MA will on the Designated Date amend the register maintained by the MA in accordance with section 20 of the BO to reflect the change in the institution's status from DTC to RLB, and will as soon as reasonably practicable thereafter, publish in the Gazette a notice of such amendment;

(iii) DTCs that do not upgrade to become an RLB or LB before the end of the 5-year transition period will be deemed to have requested the MA to revoke its authorization as a DTC, and the MA will follow usual processes to handle the revocation; and

(iv) for the avoidance of doubt, DTCs that wish to upgrade to become a LB will be required to apply to the MA under section 15 of the BO.

(b) The Converted RLB shall be permitted, on and after the Designated Date, to continue to hold (including to renew or roll over immediately at the end of its term) up to the end of the 5-year transition period a deposit taken by the institution before the Designated Date of less than HK$500,000 but at least HK$100,000 provided that any renewal or roll-over of the deposit shall have a term to maturity of no less than 3 months or a period of call or notice of no less than 3 months. This permission will cease to apply if the depositor withdraws all or any part of the deposit such that the amount remaining deposited is, at any time, less than HK$100,000. For the avoidance of doubt, any new deposit taken on and after the Designated Date will be subject to a minimum amount of HK$500,000 but without any restriction on maturity.

(c) A DTC shall pay restricted banking licence fees (including licence fees and fees in respect of local branches, overseas branches and overseas representative offices) at the time of conversion to an RLB. It will receive a refund of any fees previously paid by the institution as a DTC which would otherwise have covered the period after it has become an RLB.

20. The MA's existing consents and approvals for the controllers, directors, chief executive or executive officers of the DTC shall continue in effect in relation to the Converted RLB on and from the Designated Date, and the notification requirement in respect of appointment of managers shall not apply upon the conversion. Likewise, any existing approvals from the MA for the establishment of any local branch, overseas branch, overseas representative office or overseas banking corporation shall continue in effect in relation to the Converted RLB on and from the Designated Date.

21. Any consents, approvals, dispensations, exemptions given by the MA to the institution pursuant to section 97F or section 97K of the BO, or pursuant to the Banking (Capital) Rules, Banking (Liquidity) Rules, Banking (Disclosure) Rules or Banking (Exposure Limits) Rules shall continue in force and effect

in relation to the Converted RLB on and from the Designated Date.

22. A DTC which is a Registered Institution (RI) under the Securities and Futures Ordinance is not required to submit application to remain as an RI or submit information of their relevant individuals to the HKMA again upon the conversion. DTCs will be expected to focus their resources on upgrading to the new second-tier during the transition period, and thus they are not expected to apply for licence or registration to carry on regulated activities under the Insurance Ordinance or Mandatory Provident Fund Schemes Ordinance before upgrading to the new second-tier.

23. In cases where DTCs choose to transform themselves into other types of regulated financial entities, they will need to seek the approval of the relevant regulatory authorities. To minimise impact on such DTCs and their customers, the HKMA will work closely with the relevant authorities to ensure that the transitions of such DTCs into other types of regulated financial entities will be seamless.

24. The HKMA will provide assistance to DTCs concerned as necessary to ensure that the interests of their customers will not be jeopardised as a result of their transitions. Further, there will be publicity about the new framework to provide information to the public and enable consumers to make informed choices. As with existing practice, the HKMA will publish press release upon approval of licence upgrade and issue advertisement in newspapers (English and Chinese) upon revocation of a DTC.

Capital requirement

Question 3:	Do you have any comments on the proposed minimum capital requirement for the second-tier institutions?

Comments received

25. No major comment was received on this requirement. A respondent sought clarification on the composition of the minimum capital, while another respondent sought clarification on the minimum capital adequacy ratio requirement for the new second-tier institutions.

HKMA's response

26. The new second-tier institutions will be subject to the same minimum capital requirement at the existing levels applicable to RLBs which is set out in paragraph 6(c) of the Seventh Schedule to the BO. Pursuant to subparagraph (2) of paragraph 1 of the Seventh Schedule to the BO, for the

purposes of the calculation of the paid-up share capital of a company required by this Schedule, there shall be deducted from such share capital any net debit balance (which is defined in subparagraph (1) of paragraph 1 as the aggregate of the excess of accumulated losses over accumulated profits disclosed in the profit and loss account, and other reserves separately disclosed in the balance sheet, of the most recent audited accounts of the company).

27. The HKMA's policy on capital adequacy and the overall framework for the calculation of the capital adequacy ratio of a locally-incorporated RLB upgraded from a DTC is the same as that applicable to existing locally-incorporated RLBs.

Minimum requirements on deposit-taking activities

Question 4:	Do you have any comments on the proposed minimum deposit size requirement for the second-tier institutions?

Comments received

28. A number of respondents had no objection to the proposed minimum deposit size requirement for the new second-tier institutions. One of the respondents asked (i) whether exemption from the minimum deposit size requirement could be granted to dormant accounts with a deposit balance below HK$500,000, and (ii) how dormant accounts should be handled upon voluntary revocation of DTC registration.

29. Two respondents suggested lowering the minimum deposit size requirement to HK$250,000 or HK$300,000 with a view to providing broader public access to deposit services and increased options of deposit placements, and facilitating the new second-tier institutions to attract more depositors as there had been a general decline in customer deposits for RLBs and DTCs over the past three decades, and that other jurisdictions do not impose minimum deposit size requirement on deposit-taking institutions that are not full licensed banks.

30. A respondent suggested including the new second-tier institutions into the DPS and at the same time removing the minimum deposit size requirement; or else, the minimum deposit size requirement should be raised to align with the new deposit protection limit proposed by the Hong Kong Deposit Protection Board. Likewise, a respondent suggested raising the minimum deposit size requirement taking into consideration inflation and the new deposit protection limit.

HKMA's response

31. As noted in the Consultation Paper, the purpose of the minimum deposit size requirement is to distinguish retail depositors from non-retail depositors. The existing HK$500,000 requirement for RLBs was laid down in 1981 with no change made over the past 40 years despite inflation. Lowering the threshold to below HK$500,000 would be inappropriate. Also, the purpose of the DPS protection limit is not to draw any line between business allowed for LBs and that for RLBs, and hence should not be used as a reference for setting the minimum deposit size requirement for the new second-tier. The HKMA maintains its view that it is appropriate to keep the minimum deposit size requirement for the new second-tier at HK$500,000.

32. To minimise the potential impact on existing depositors of DTCs (defined as those who have deposits placed with the Converted RLBs before the Designated Date), the HKMA inclines to give flexibility to them in meeting the new minimum deposit size requirement. As explained in paragraph [19(b)] above, it is intended that an outstanding deposit taken before the Designated Date may continue up to the end of the 5-year transition period subject to the pre-existing deposit size requirement of HK$100,000 and (in case of renewal or rollover immediately at maturity) also the 3-month maturity restriction under the new framework provided that any renewal or roll-over of the deposit would not render the maturity of the deposit falling on a date beyond the end of the transition period. On the other hand, any new deposits taken (including those taken from existing depositors) on or after the Designated Date will be subject to the deposit size requirement of HK$500,000.

33. As for dormant accounts, it is intended that the account balance may be transferred to some form of suspense account on the Designated Date and it should not then be subject to the deposit related requirements of RLBs or DTCs. In the event of voluntary revocation, under the Eighth Schedule to the BO, the MA must be satisfied that the interests of the depositors of the revoking Authorized Institution will be adequately safeguarded, including those of dormant accounts. In this regard, when a DTC is seeking to wind down its business in Hong Kong and revoke its registration, the HKMA will usually require the institution to repay as far as practicable all of the deposits taken by it. Where this proves not to be possible, the institution will be required to make adequate and legally effective arrangements for the future payment of the unclaimed moneys arising from any deposit liabilities not repaid by the date of revocation. DTCs applying for voluntary revocation are advised to discuss their revocation plans and arrangements with the HKMA in advance. The HKMA will provide guidance along the way as appropriate.

Access to Real Time Gross Settlement systems

Question 5: Do you have any comments on the proposed arrangement for access to the RTGS systems of the new second-tier?

Comments received

34. Some respondents supported the proposal to allow all second-tier institutions to apply for access to the Real Time Gross Settlement (RTGS) systems, noting that this would enhance the institutions' flexibility and efficiency in conducting business, which could translate into better service to their customers.

35. A couple of respondents commented that access to RTGS systems by second-tier institutions should be optional, not mandatory, as not all institutions would require such access depending on their business models. One of the respondents also suggested that the existing acceptance criteria for access to RTGS systems[1] should be reviewed or removed, taking into consideration recent developments in payment systems including the launch of the Faster Payment System.

HKMA's response

36. The HKMA does not intend to make access to the RTGS systems a mandatory requirement for the new second-tier. As with existing arrangements for RLBs, new second-tier institutions may, depending on their business needs, apply to join the RTGS systems for handling payments and settlement of securities transactions through the Central Moneymarkets Unit and the Hong Kong Securities Clearing Company Limited. The HKMA considers that the existing criteria for access to the RTGS systems are reasonable and still relevant in present day circumstances.

Nomenclature

Question 6: Do you agree that the current nomenclature of RLBs should be kept for the new second-tier? If not, do you have any suggestions on the new name?

[1] Since 2000, RLBs can apply for access to the RTGS systems. The HKMA will evaluate whether an RLB has a valid business case for their access to the RTGS systems, taking into account the access criteria set out in the HKMA circulars "Access to the Real Time Gross Settlement System" issued on 29 December 1999 and 19 May 2000, which include mainly: (a) whether a RLB has a large number of money market, foreign exchange and securities transactions; and (b) whether a RLB has high value of interbank transactions.

Comments received

37. A number of respondents agreed that the current nomenclature of RLBs should be kept for the new second-tier.

38. A few other respondents commented that a new name should be devised for the new second-tier. One of the respondents remarked that some of its potential customers considered the term “Restricted” somewhat pejorative, and suggested “Universal Bank”, “Designated Bank” or “Reserve Bank” as an alternative. It also proposed waiving the requirement for second-tier institutions to compulsorily display “Restricted Licence Bank” designation alongside with the bank’s name, if it was decided that the current nomenclature should be kept. Likewise, the other two respondents proposed replacing the existing nomenclature with a more positive one to enhance customers’ confidence in the second-tier institutions while reflecting the limited status of these institutions. The suggested new names included “Second-tier Bank”, “Merchant Bank”, “Wholesale Bank”, “Tier Two Bank” or just the short form RLB after the bank’s name.

39. There was a comment that the HKMA should consider allowing all second-tier institutions to incorporate under and use a banking name.

HKMA’s response

40. Any change to the nomenclature should be appropriate and provide an accurate description of the business activities of the second-tier institutions. The HKMA has considered the alternative names proposed by the respondents, but none is considered a good alternative that can accurately describe the diverse business nature of the second-tier institutions. Also, the proposed term “Second-tier” or “Tier Two” does not appear to be more positive than the existing term “Restricted”. As such, the HKMA is of the view that the existing name “Restricted Licence Bank” should be kept for the new second-tier.

41. As with existing policy on the use of banking name, a second-tier institution that is a branch of a foreign bank or a local subsidiary of a bank will be allowed to use a banking name on the conditions that such name (a) is used in immediate conjunction with the term “restricted licence bank”; and (b) is not more prominent than the term “restricted licence bank”. The HKMA considers that the existing policy remains appropriate for the new framework, as it is important for depositors to know clearly the type of institution they are dealing or intend to deal with.

Other considerations

Question 7: Do you recommend any other changes to the three-tier banking system?

Regulatory requirements and supervisory approach

Comments received

42. A respondent asked whether DTCs would be required to meet certain requirements on deposit-taking business (e.g. on the amount of new deposits taken, total amount of customer deposits, etc.) after upgrading to the new second-tier.

43. A respondent asked whether those second-tier institutions converted from DTCs would be subject to the same regulations as RLBs after the 5-year transition period, or would there be any exceptions for the DTCs. It hoped that the degree of regulation would be maintained at the existing level, reflecting the size of operation of each institution.

44. A respondent commented that the current parent companies of DTCs should be allowed to continue to hold the new second-tier institution or LB despite that these companies were non-financial institutions.

45. A respondent commented that since the 2008 Global Financial Crisis, the banking industry had been subject to increased compliance costs due to higher supervisory expectations. It proposed the HKMA to explore the possibility of adopting a targeted and customised supervisory approach in accordance with the scale, complexity, specific business models and risk profiles of the Authorized Institutions, with the objective of enabling small institutions to conduct and develop a sustainable business that contributes to the safety and soundness of the sector.

HKMA's response

46. The HKMA does not intend to add an extra layer of requirements for the second-tier institutions as a result of the simplification of the three-tier banking system.

47. All second-tier institutions, be they upgraded from existing DTCs or new entrants, will be subject to the supervisory requirements applicable to existing RLBs. Apart from the minimum capital and deposit size requirements and the 3-month maturity restrictions on DTCs, there is no difference in the principles of supervisory requirements between RLBs and DTCs.

48. On ownership of the second-tier institutions, the existing requirements for locally-incorporated Authorized Institutions will continue to apply under the new framework. Pursuant to the arrangement as set out in paragraph 20 above, existing controllers of DTCs shall continue to be controllers of the new second-tier institutions, unless they are no longer fit and proper.

49. The HKMA has been adopting a risk-based supervisory approach, and Authorized Institutions devise systems and controls commensurate with the scale and complexity of their business in complying with regulatory requirements. Further, in response to challenges faced by the industry due to fast-evolving market circumstances and new international standards, the HKMA has adopted a Balanced and Responsive Supervision (BRS) Programme since 2017 to drive a more effective supervisory outcome as well as establish a more conducive environment for banking development as underpinned by a proportionate and risk-based supervisory approach. The BRS initiative has provided a useful platform for the HKMA and the industry to exchange views and have constructive dialogues on how to support the further development of the banking industry.

Deposit protection

Comments received

50. A few respondents commented that DPS membership should be expanded to include second-tier institutions to enhance confidence in these institutions and encourage customer deposits. One of them also suggested applying DPS requirements to the second-tier institutions on a proportionate basis (e.g. the protection limit could be less extensive than that for DPS member banks). Another respondent was however aware of the cost implication on the second-tier institutions.

51. On the other hand, a respondent hoped that second-tier institutions would be excluded from the DPS in general while having the flexibility to join on a voluntarily basis.

52. A respondent proposed that second-tier institutions should be allowed to provide deposit insurance to its clients from third party insurers who might be willing to insure such deposits.

HKMA's response

53. The Hong Kong Deposit Protection Board (the "Board") issued in February 2024 a Consultation Conclusions Paper relating to its public consultation on enhancements to the DPS in Hong Kong (the "DPS Paper"). It is noted in the DPS Paper that ordinary retail depositors only have very limited access to DTCs and RLBs, and that the Board will continue to monitor the latest developments on this front and review the membership of the DPS if needed.

Impact on banking stability

Question 8:	Do you agree that the proposed simplification shall not have significant impact on banking stability as well as customers and depositors of the existing DTCs?

Comments received

54. The majority of the respondents agreed that the proposed simplification should not have significant impact on banking stability.

55. A respondent commented around the extent of likely impact to customers, market competition and consumer choice. It explained that merging of DTCs into the RLB sector would raise the market entry threshold as the minimum capital requirement would increase. It also considered that consumers who were for some reason unable or unwilling to deposit with the first-tier institutions would be left with the option of RLBs only and subject to the requirement of a higher minimum deposit size requirement of HK$500,000. Further, with less market competition, depositors with deposits less than HK$500,000 might face the problem of less favourable terms of services or be forced to be out of the banking system. Apart from deposit services, the proposed simplification could also reduce the choices available to consumers in other financial services (e.g. fund management, personal loans, property mortgage loans, hire purchase loans, money remittance, etc.) which had been provided by DTCs. The respondent also expressed concern that the proposed simplification could indirectly encourage entries into other financial activities that lack a sector specific regulator. The respondent suggested the HKMA closely monitor the situation and to take timely measures as appropriate. However, the respondent reckoned that the Government's policy to facilitate smart banking and establishment of virtual banks may mitigate its mentioned issue of reduced market competition and less choice for consumers.

56. A respondent commented that, in the short term, some customers might be impacted by the disappearance of an opportunity to place deposits with the higher level of interest paid by some DTCs. That said, the public as a whole would benefit and be better served by a more streamlined banking system in the long term. It noted that broad communication and education to the public would be required for better customer experience and ensuring the public's understanding of the proposed simplification.

57. A respondent commented that impact on customers and depositors of existing DTCs could be significant. For instance, requesting small depositors to either close their account with a DTC or top up their deposit amount to HK$500,000 could be a significant and/or unnecessary disruption from the customers' perspective.

58. A respondent recommended that consideration be given to further consulting key industry stakeholders on the impact of the proposed changes on the banking system, so as to ensure a balanced and sustainable implementation of the initiative, and safeguard the interests of DTCs and their customers.

HKMA's response

59. As mentioned in the Consultation Paper, the DTC sector's market share in the banking sector has dropped significantly over the past three decades. As of 31 December 2023, the existing DTCs only had about 2,500 deposit customers in total. The total assets of DTCs accounted for only 0.07% of the banking sector. About half of the DTCs have minimal business activities, with total customer deposits amounting to around or less than HK$1 million. Further, the deposit-taking business activities of the DTC sector have been dominated by a few larger players. Almost 90% of the sector's customer deposits was taken up by the largest DTC (in terms of total capital and assets), while the three largest DTCs accounted for almost 86% of the sector's total loans and advances. The HKMA will closely monitor the transition of these larger players and provide assistance as appropriate to minimise impact on the institutions and their customers.

60. The HKMA has sought the preliminary views of the DTCs on their future business plans. It is noted that the majority of the existing DTCs have indicated intention to upgrade to the new second-tier. A few of these DTCs have even indicated plans to reactivate their business activities, which will help revitalise the second-tier and provide customers with more choices. As for those DTCs that have yet to decide on the way forward, they either have associated entities in Hong Kong that are LBs which can take up the DTCs' business activities and customers, or only have a very small scale of business with miniscule market share.

61. As noted in paragraph 32 above, it is intended that flexibility will be given to existing customers of DTCs in meeting the new deposit size requirement with a view to minimising the impact on existing depositors of the DTCs. At present, there are 149 LBs and 16 RLBs which provide a wide range of financial services including those currently offered by the DTCs. Moreover, the rapid development and wide adoption of financial technology by the LBs has enabled the LBs to lower their operation costs, allowing them to offer better terms of services to their customers. Notwithstanding that the minimum deposit size requirement for the second-tier is higher than the existing requirement for the DTCs, there will be no restrictions on the maturity of deposits placed by customers. This flexibility of second-tier institutions in offering deposit services is beneficial to both the institutions and their customers.

62. Last but not least, notwithstanding that the minimum capital requirement for the DTC sector is the lowest among the three tiers, the HKMA has not received any DTC applications since 2009, reflecting the lack of interest in

the participation in the DTC sector, while 7 RLB licence applications were approved between 2009 and 2023.

63. In light of the above, the HKMA maintains its view that the impact of the proposed simplification on banking stability and market competition, as well as that on customers and depositors, would not be significant.

IV. Conclusions and Way Forward

64. Following the issuance of this Conclusions Paper, the HKMA will embark on the preparation for the detailed legislative amendments to effect the proposed changes.

65. Going forward, the HKMA will provide guidance to DTCs in their transition to the new framework and work on the publicity of the new framework.

66. The HKMA would like to take this opportunity to thank all respondents for their valuable comments.

Annex - List of Respondents

(in alphabetical order)

1. Consumer Council
2. Hong Kong General Chamber of Commerce
3. KPMG
4. PwC
5. The DTC Association (representing 4 DTCs and 1 RLB)
6. The Hong Kong Association of Banks

The name of one other respondent is withheld from disclosure at its request.