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ABSTRACT

This column provides a country-by-country analysis of the latest legal developments, cases and issues relevant to the IT, media and telecommunications' industries in key jurisdictions across the Asia Pacific region. The articles appearing in this column are intended to serve as 'alerts' and are not submitted as detailed analyses of cases or legal developments.

1. Hong Kong

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1.1. *The Future is Here: New Guidelines Issued by the HKMA for Virtual Banks*

On 30 May 2018, the Hong Kong Monetary Authority ("**HKMA**") issued a revised Guideline on Authorisation of Virtual Banks ("**Revised Guideline**"), following the public consultation that ended on 15 March 2018.[2] The Guideline will supersede the previous Guideline on Authorization of Virtual Banks issued by the HKMA in 2000 ("**2000 Guideline**"), in which the HKMA had taken a more cautious approach to the authorisation of virtual banks. In particular, under the 2000 Guideline only banks and other authorised institutions could operate a virtual bank.

The Revised Guideline sets out the principles that the HKMA will take into account in deciding whether to authorise a virtual bank in Hong Kong. A virtual bank is defined as "a company which primarily delivers banking services through the internet or other forms of electronic channels instead of through physical branches".[3] The Revised Guideline now opens the door for technology companies and any other businesses established in Hong Kong to apply for a licence in order to own and operate a virtual bank – such is no longer limited to authorised institutions.

So far, over 50 companies have indicated to the HKMA that they are interested in applying for a virtual banking licence. The HKMA is expecting an influx of applications and has already indicated that applications received after 31 August 2018 may not be processed by the HKMA as part of the first round of applications.

The HKMA intends to grant priority to applicants who can show that they:

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[2] See our previous article entitled "Virtual Banks – New Reality Welcomed by the Hong Kong Monetary Authority".

[3] http://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2018/20180530e3a2.pdf.

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(a) have the sufficient resources necessary to operate a virtual bank, including financial and technology resources;
(b) have a business plan that is both credible and viable, and would "provide new customer experience and promote financial inclusion and fintech development";[4]
(c) have developed or have the ability to develop an IT platform that can support their business plan; and
(d) can commence operations shortly after a virtual banking licence is granted.

1.1.1. *Revised Guidelines*

Based on the comments received from 25 respondents during the consultation process, the HKMA amended the Revised Guideline released for public consultation on 6 February 2018 ("**Public Consultation Guideline**"). In summary, the main changes introduced by the Revised Guideline to the Public Consultation Guideline are as follows:

(1) Ownership
The Revised Guideline (unlike the 2000 Guideline) does not require a bank or financial institution to own 50% or more of the shares in the virtual bank applicant, so long as the owner is an intermediate holding company incorporated in Hong Kong, with supervisory conditions imposed on them. Under the Public Consultation Guideline, the supervisory conditions to be imposed were limited to conditions relating to maintaining adequate capital, risk management and submitting financial and other information to the HKMA. The Revised Guideline now sets out a list of further factors that the HKMA may impose in the exercise of its supervisory powers, including conditions relating to liquidity, group structure, fitness and propriety of senior managements, etc.
A stronger obligation is also imposed on the parent companies of virtual banks. Rather than merely having to provide managerial, financial and technology support as appropriate – they must now commit to support the virtual bank and be capable of providing "strong" financial, technology and other support, as necessary.

(2) Supervision
Virtual banks will be subject to the same supervisory requirements that apply to existing bricks and mortar banks. The HKMA clarified in the Revised Guideline that the supervisory requirements would be determined on a case-by-case basis, adopting a risk-based and technology-neutral approach.

(3) Technology risk and risk management
Virtual banks need to ensure that they have in place a resilient IT system and business continuity plan. In particular, virtual banks must carry out a detailed independent assessment of the design, implementation and effectiveness of their IT systems, including their hardware, and their system security, procedures and controls. The assessment report must then be submitted to the HKMA, prior to the virtual bank commencing their operations.

(4) Exit plan
Virtual banks are required to establish an exit plan, which will minimise disruption to their customers. The HKMA emphasised that this is an important requirement, due to the potential risks inherent in virtual banking. Further details have been added in the Revised Guideline on what the exit plan is expected to cover, i.e. the circumstances in which the exit plan should be implemented, who has the authority to trigger the exit plan, the mechanism for repaying depositors and the source of such funds.

1.1.2. *Outsourcing*

The outsourcing of IT or business functions by a virtual bank to a service provider is permitted. However, any material outsourcing needs to be discussed with the HKMA in advance, and it must comply with the HKMA's Supervisory Policy Manual (SA-2) on Outsourcing ("**SPM Outsourcing**").[5] This includes making sure that the virtual bank maintains adequate security controls over the service provider, that customer information processed by the service provider will remain secure and confidential, the Personal Data (Privacy) Ordinance (Cap. 486) will be complied with, and the HKMA has the right to carry out any inspections of the service provider's security measures.

One suggestion received during the consultation process was that the HKMA issue a pre-approved "safe" list of service providers that virtual bank applicants can use, without requiring the HKMA's prior consent. The HKMA has not adopted this suggestion on the basis that one size does not fit all. A service provider may not meet the HKMA's supervisory requirements in relation to all of their services, and different virtual banks will have different systems and internal measures. It is therefore necessary to determine whether the outsourcing of any functions to a particular service provider is appropriate, depending on the circumstances.

The HKMA indicated that it might make exceptions to the requirement for virtual banks to comply fully with the SPM Outsourcing, if they can demonstrate that they can achieve the HKMA's supervisory conditions through other alternative means. However, exactly what those alternatives means may be remains unclear.

1.1.3. *Takeaway*

Applicants for virtual banking licences will need to acquire the necessary IT resources, whether via joint ventures, the hiring of new staff or outsourcing arrangements, before they submit their application for a virtual banking licence. In the rush to get ready and be among the first wave of applicants, potential licensees should take heed and ensure that any joint venture agreements or outsourcing contracts fully protect their interests. With regard to the latter, it is particularly important to ensure that minimum security measures are imposed on the service provider, and appropriate indemnities are included to allow the applicant to recover any losses. Rushing headfirst without having the proper legal contracts and protections in place will inevitably cause problems in the long run, and could even jeopardise the application for a virtual banking licence.

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[4] http://www.hkma.gov.hk/eng/key-information/press-releases/2018/20180530-3.shtml.

[5] http://www.hkma.gov.hk/media/eng/doc/key-functions/banking-stability/supervisory-policy-manual/SA-2.pdf.