

Executive Summary

According to a *Business Insider* research service report, the total value of all the world's virtual banks equalled USD 18.6 billion in 2018, with 26 million users and 50 million accounts. It is expected that the growth of virtual banks is rapid and the total value will increase to USD 63 billion in 2024, with 98 million users and 187 million accounts¹.

The Hong Kong Monetary Authority published a revised set of guidelines on the authorisation of virtual banks in 2018. Its objective is to promote financial inclusion by encouraging FinTech and innovation in Hong Kong and to offer a new kind of customer experience. The Authority issued 8 virtual bank licences last year. Two of them have already started to operate, whilst the rest are expected to launch soon². This will greatly impact the ecology of the financial service industry in Hong Kong.

"Virtual banks" are banks that primarily deliver retail banking services through the internet or other forms of electronic channels instead of physical branches. Their clients include both individuals and small- and medium-sized enterprises (SMEs)³. It is expected that the development of FinTech in Hong Kong can be enhanced through virtual banks. The cost of operating virtual banks can be much lower since they do not have physical branches. They can also operate around the clock for the convenience of customers. Therefore, virtual banks have greater incentives to provide services to people with low assets and low incomes and to SMEs, such as convenient small loans, which helps to facilitate economic diversification and, ultimately, to achieve financial inclusion.

¹ Business Insider. (2019). "The Global Neobanks Report: How 26 upstarts are winning customers and pivoting from hyper-growth to profitability in a \$27 billion market." Retrieved March 2, 2020, from <https://www.businessinsider.com/global-neobanks-report>

² HKMA. (March 27, 2019). "Virtual bank licences issued." Retrieved from <https://www.hkma.gov.hk/media/chi/doc/key-information/speeches/s20190327c1.pdf>

³ HKMA. (2020). "Virtual banks." Retrieved February 26, 2020 from <https://www.hkma.gov.hk/eng/key-functions/banking/banking-regulatory-and-supervisory-regime/virtual-banks/>

The media has reported cases of SMEs encountering difficulties in opening accounts and applying for loans in banks with physical branches⁴. Virtual banks should have greater incentives to provide services to those who are usually overlooked by large banks, including young people who have recently entered the workforce and young entrepreneurs. Besides, virtual banks are more welcomed by generations X, Y and Z⁵ than traditional banks⁶. However, whether virtual banks' services can benefit the younger generation still depends on the success of their businesses and whether their services can respond to young people's specific needs.

In view of this, this study aims to look at the bank service requirements of young active bank users and business operators (the main client group of virtual banks) as well as their confidence in and worries regarding virtual banking. Firstly, it tries to understand these aspects through an on-site youth survey. Secondly, it tries to understand the specific situations and common problems they encounter with bank services through in-depth interviews with young active bank users and business operators. Thirdly, it tries to understand the advantages and disadvantages of the development of virtual banks in Hong Kong as well as the challenges they face through expert interviews. By synthesising these analyses and information, it is hoped that feasible recommendations can be made to facilitate young people's access to financial services through virtual banking and to respond to the needs of young people.

This study uses data collected by three methods during the period from April to May 2020: an on-site survey of 525 young people aged 18-39, case interviews with 20 young active bank users and business operators aged 18-39, and interviews with five experts and related parties.

⁴ On.cc. (April 8, 2019). "Improvements in opening accounts but loans are still difficult." Retrieved June 29, 2019, from https://orientaldaily.on.cc/cnt/finance/20190408/mobile/odn-20190408-0408_00202_033.html

⁵ Generations X, Y and Z represent those who were born in 1965-76, 1977-94 and 1995-2004, respectively.

⁶ J.D. Power. (2019). "In direct bank gold rush, top performers find different paths to success, J.D. Power Finds." Retrieved March 2, 2020, from <https://www.jdpower.com/business/press-releases/2019-direct-banking-satisfaction-study>

Main Discussion

- 1. The rise of mobile networks and changes in users' behaviours in recent years provide a mature environment for the development of virtual banks. All virtual banks in Europe, America and Mainland China target clients overlooked by large banks such as medium-, small-sized and mini enterprises, low asset clients and young people, so that more people can access financial services. Among them, the virtual banks in Mainland China have turned out to be the most successful with their huge customer base.**

The rise of mobile networks and smartphones has changed their users' behaviours and provided an ideal environment for virtual banks to develop. Most virtual banks in the world target clients that are usually ignored by large banks, especially medium-, small-sized and mini enterprises as well as low-asset clients and young people. Virtual banks provide them with diversified financial services so that they can be benefited. Among the different virtual banks in the world, those in Mainland China are the most successful. Most virtual banks in Mainland China have been set up via social media and electronic commercial platforms, where they have already accumulated a huge base of loyal enterprise and individual customers. These virtual banks have launched services designed for small-sized and mini enterprises as well as individual consumer credit markets. They have also made use of big data analysis and artificial intelligence to control the risk of small loans so that they are able to occupy the market ignored by traditional banks and become successful.

- 2. The service of physical banks is not able to satisfy the financial needs of Hong Kong young people. Reasons for this include: denial of access to certain services due to low balances, high minimum thresholds for investment products, difficulty getting small loans for individuals and start-ups, bad experiences with online services, etc.**

The on-site survey findings of this study show that 79.0% of the 525 respondents think that being "fast" is the important element of bank services, followed by "privacy protection" (76.4%) and "stability of the bank" (58.5%). As for services designed for low-asset customers, 80.8%

of the respondents think that “help low asset customers set up individual financial plan” is beneficial to their financial management, whilst 73.3% and 69.9% think the same for “small investment under HKD10,000” and “small savings under HKD10,000”, respectively. Younger groups and customers with low and medium assets tend to agree that these services are useful. However, physical banks may not be able to satisfy these needs.

Some young people interviewed said they encountered problems with the service of physical banks, including the denial of access to certain services due to low balances, high minimum thresholds for investment products and high charges for small investments, difficulty getting small loans for individuals and start-ups, bad experiences with online services, etc. These reflect that physical bank services are unable to cover the needs of low-asset young customers, SMEs and start-ups.

- 3. The emergence of virtual banks is expected to offer more choice of bank service to SMEs, young people who run start-ups and low asset customers in order to attain financial inclusion. Experts generally agree that virtual banks can provide a more convenient channel for opening accounts, deposits, investment and credit. But the public is still worried about the misuse of privacy. The conservative commercial environment is also detrimental to the development of virtual banks.**

The Hong Kong Monetary Authority has issued eight virtual bank licences, two of which have started to operate. The backgrounds of these organisations are diversified and they should be able to apply their sector services to virtual banking.

Experts and academics point out that virtual bank systems are built upon new technology which operates with a completely new business model. Therefore, it can simplify its service procedures more easily and match today’s users’ habits to offer better user experience. Furthermore, virtual banks need to attract both deposits and credits with inclusive finance standards. Therefore, they can provide a more convenient channel for opening accounts, deposits, investment and credit for SMEs and start-ups with low capital, small businesses and young people with low deposits. However, there are still some potential problems with virtual

banks. These include: public worries regarding the easy misuse of privacy, trust in virtual banks, network safety and technology stability, operation and credit risk, and conservative attitudes towards applying innovative technology in the commercial ecology.

- 4. Electronic banking and non-physical transaction channels are generally accepted by young people. They are well prepared to use virtual banking services. However, how much younger groups and people with lower assets and lower educational attainment can be benefited from electronic banking services depends on service coverage and the method of implementation.**

Ninety-seven percent of the survey respondents have used banking services via personal computers or mobile phones, whilst 92.1% of them use electronic banking at least once a month. Most of the respondents have used electronic payment, the most popular of which is “purchase with Octopus” (99.8%). Of the respondents, 96.9% use electronic payment at least once a month whilst 84.2% use it at least once a week. These show that electronic banking and non-physical methods of transaction are generally accepted by young people, who are well prepared to use virtual banking.

Nevertheless, the survey finds that the percentage of respondents who have tried electronic payment is higher for those who are older, are higher-level bank customers and have higher educational attainment. This may be related to the types of bank services that people can get access to, such as whether they have a credit card and bank account. The result reflects that for people who are younger, with lower assets and with lower educational attainment, the degree to which they can benefit from electronic bank services depends on service coverage and the method of implementation.

- 5. More than 60% of the young respondents think that the main benefit of virtual banking is that it is “fast”, which they also feel is the most important element of bank services. However, they are still worried enough about network security, privacy protection and bank stability that their confidence is low at the present stage.**

Seventy-three percent of the respondents have heard about “virtual bank”, meaning that it is still not remarkably popular, while 63.0% think the benefit of virtual banking is that it is “fast”, which they also feel is the most important element of bank services. Furthermore, 35.0% and 24.6% think important elements are “round the clock service” and “unrestricted location”, respectively. However, although their choice of important elements of bank service include “privacy protection” and “stability of the bank”, their confidence in these aspects of virtual banks is low. Out of a possible total confidence level of 10 points, they only give 5.35 points, 4.77 points, 4.72 points and 4.55 points on average to “electronic transaction systems of virtual banks”, “depositing cash in virtual banks”, “regulation of virtual banks” and “security of personal data in virtual banks”. This shows that their confidence level in general is lower than half. Just over half (53.1%) of the respondents said they worry about “insecure network”, while just under half (48.6%) said they worry about “insufficient privacy protection”. Significant numbers of the respondents also worry about “insufficient regulation” (37.9%) and “weak bank background or reputation” (22.1%).

Some interviewees said that they prefer to put their money in physical banks at the present stage because of their lack of confidence in virtual banks. They will observe the operation of virtual banks for a period of time before starting to use them. Some other interviewees said they worry their patterns of personal consumption will be tracked and their privacy will be exposed since virtual banks usually focus on electronic payment.

- 6. Virtual banks need to provide services to match the daily operational needs of enterprises and to solve the problems generated by incomplete commercial services so that enterprises are able to experience their convenience. Examples include cheque and cash deposits and cash withdrawals as well as complete transaction records.**

Virtual banks may not be able to provide complete commercial services. For example, they may not allow cheque and cash deposits and cash withdrawals. Their systems may not be convenient for bank transaction reconciliation, either. Such arrangements may cause inconvenience to business operations. An interviewed business operator said that he

needs to withdraw cash from the bank to pay the salary of part-time staff. Another business operator worried that virtual banks could not issue complete formal records of transaction, which is inconvenient to business operation. Therefore, virtual banks need to provide services to accommodate the daily operational needs of enterprises so that enterprises are able to experience their convenience.

Recommendations

Based on the above findings and discussion, the following recommendations are offered in order to facilitate young people's access to financial services through virtual banking.

- 1. The Hong Kong Monetary Authority and the Privacy Commissioner for Personal Data should strengthen public education about personal privacy protection.**

The Hong Kong Monetary Authority and the Privacy Commissioner for Personal Data should demonstrate their determination to maintain privacy protection and internet security. They should explain to the public that virtual banks need to comply with the same privacy and internet security regulations as physical banks so as to enhance public confidence. Both organisations should work together to strengthen public education about personal privacy protection such as people's rights and things to attend to when agreeing for personal data to be acquired by various organisations.

- 2. Virtual banks should provide personalised and intelligent self-help financial analyses and recommendations to clients. Regulatory bodies for investment should also study ways to allow virtual platforms to provide such services.**

Virtual banks should make use of FinTech such as artificial intelligence and big data analysis to provide intelligent self-help financial analyses and recommendations to individual and commercial clients, including young bank users and young entrepreneurs. By understanding their own financial needs and the

risk levels they can tolerate, clients can plan their finances and make their choices better. At present, all services related to the financial decisions of savings, investment and insurance are under regulation. Regulatory bodies should study ways to allow virtual platforms to perform better given the present mature development of FinTech so that they can serve those in need.

3. Virtual banks should provide discounts to encourage merchants to try electronic payment services. They could also provide channels for cash and cheque deposits during the transitional period from cash to non-cash transactions.

Virtual banks should help SMEs to adapt to the change from cash to non-cash transactions. In view of the necessity of cash deposits among retail merchants and physical cheque transactions in commercial trades, virtual banks should provide channels for cash and cheque deposits during the transitional period. In the long run, virtual banks can provide incentives to encourage merchants, consumers and different enterprises to try electronic payment services. They can provide free trials or discounts for these services in order to speed up transactions and reduce their costs.

4. Virtual banks should develop accounting systems that match the daily operational needs of SMEs as well as provide complete electronic transaction records.

Virtual banks should take into account the daily operations of SMEs and develop accounting systems that match with the systems that are commonly used in the commercial sector for the convenience of bank transaction reconciliation. In addition, they should also attend enterprises' need for complete transaction records and provide formal electronic records for electronic business transactions.