A spokesman from BOCHK said Hong Kong's offline payment market has been highly developed

Hong Kong banks are lagging behind regional peers in digitisation drive

Legacy systems, regulatory challenges, and exposure to the mainland are taking a toll on banks' operations.

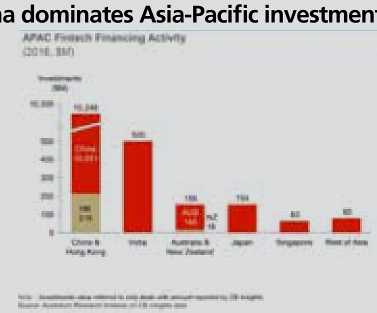
Singapore and other global financial hubs trump Hong Kong again as the latter remains stuck in a mire of issues, old and new. With the rapid increase in digital disruptions, Hong Kong's banking executives and the Hong Kong government are faced with a huge balancing act of restructuring the banking industry whilst keeping tabs on the latest digital innovations. The city's excessive exposure to mainland China has also made things a bit more complex, especially since the mainland has been receiving way more investments in fintech than Hong Kong.

Some experts agree that legacy systems are the major drag for Hong Kong's financial institutions and that a drastic industry overhaul has been long overdue. Despite the introduction of mobile apps and the rise in the number of online offerings, banks still lag in terms of straight through processing in services such as credit card applications. **Alicia Garcia Herrero**, chief economist for Asia Pacific, Natixis, said that to prepare for the digital era on a sustainable basis, banks could use a shortcut by starting from scratch with a parallel bank, but with the in-house or client knowledge. Meanwhile, other experts believe that as the regulatory environment remains difficult, firms can begin transforming internally through the creation of a forward-looking and innovative culture among their employees.

"System renewal is on every bank's agenda, and legacy systems and processes put a real brake on a bank's ability to adapt and change quickly. However, in our experience, many benefits are possible that do not require immediate systems improvements. Changing staff behaviours to be more customer and digitally oriented, eliminating redundant legacy policies, and redesigning processes can all have significant impact whilst investment in digital building capabilities is underway. The prize of pulling these levers is a triple play of customer experience improvement, employee experience improvement, and financial benefits," said **Richard Hatherall,** partner, Bain & Company.

Garcia Herrero said that as a

China dominates Asia-Pacific investments



Source: Accenture

result of this and a host of other factors, Hong Kong's current fintech workforce is the smallest among the main fintech centres. Lack of public funding programmes and a high competition from China also led to the city being ranked second last in terms of access to capital among seven global fintech centres including the United Kingdom, California, New York, Singapore, Germany, and Australia. While fintech investment in the UK has reached around £524m, investment in Hong Kong has been slow to catch up at a measly £46m.

Mobile payments

The world of mobile payments also sees Hong Kong as a laggard, particularly when compared to China. **Michael Wang**, deputy general manager of E-Finance Center, Bank of China (Hong Kong), said that Hong Kong's disadvantage can be attributed to differences in business environments and people's payment habits. Consumers in the mainland have been quick to respond to the rise in smartphones and, consequently, the rise in online shopping payments during the last decade.

"Meanwhile, Hong Kong's offline payment market has been highly developed, in which people can always buy what they want easily through the contactless smart card system. A process of change in the payment habits of Hong Kong people is needed to foster the growth of mobile payments. With the efforts of different parties, together with the recent changes in customer payment habits, the mobile payment market of Hong Kong can be expected to grow further," Wang added.

However, despite distinct differences, whatever happens to China's banking and finance industry is immediately felt in nearby Hong Kong. **Chua Han Teng,** head of Asia country risk, BMI research, said that the loan books of Hong Kong banks are highly exposed to mainland China, and they are therefore vulnerable to a slowdown in the Chinese economy. In order to reduce risks, Hong Kong banks are expected to slow lending towards less profitable state-owned enterprises versus private companies. "Hong Kong banks are also exposed to the overvalued domestic housing market, and a significant negative price shock would undermine asset quality. Hong Kong regulators are wary of financial instability, and they have been putting in place macro-prudential measures to slow property lending," he added.

Garcia Herrero agreed that the top three risks for Hong Kong banks are excessive exposure to Chinese corporates, a large correction in Hong Kong's real estate market, and pressures on the Hong Kong dollar. She further noted that whilst appreciation pressures have eased recently, the Hong Kong Monetary Authority cannot keep on accumulating reserves without revaluing the currency.

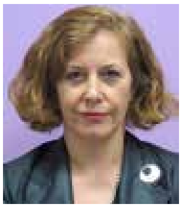
The Hong Kong economy does not seem to be in the doldrums, as the first half of this year saw the strongest showing of loan growth since 2011, said **Asheefa Sarangi,** analyst, CLSA. Sarangi noted that financial concerns has been the biggest key sector driving demand. However, the coming months are expected to slow down with the recent property measures forwarded by HKMA.

All hope is not lost

The bigger picture may look very grim, but Hong Kong has made several moves to ensure that progress happens, albeit slowly. With developments in the UK and Singapore, Hong Kong implemented last year a fintech sandbox to provide appropriate regulatory support by relaxing specific legal and regulatory requirements for fintech. Garcia Herrero said that in order for this move to work, Hong Kong's regulatory regime must be simpler, clearer, and more transparent in order to attract new fintech players.

"Hong Kong should increase its cooperation with the Chinese government on fintech matters to have a mutual regime and better access to each other's market. Hong Kong should also increase its taxation policy incentives to catch up with UK and Singapore initiatives," Garcia Herrero noted.

Amidst threats from non-traditional competitors, banks continue to find ways through the regulatory labyrinth



Alicia Garcia Herrero

Richard Hatherall

Chua Han Teng

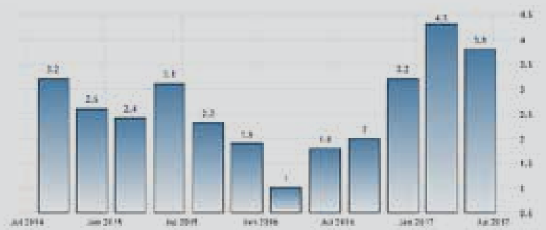
Michael Wang

in order to meet the demands and expectations of their evolving clientele. Hatherall said that banks should develop omni-channel sales and service propositions, migrate services to digital channels, finding new ways to engage customers, leverage new technologies to improve the customer experience.

At the present, Hatherall said that banks are exploring how they can leverage new technologies like big data and advanced analytics to equip an increasingly digitally enabled frontline. "In parallel, they are looking to understand the intentions of the 'big techs' in terms of financial services. They have huge customer bases, are nimble and are increasingly building trust with customers. In China many 'big techs' also have financial services arms, the banks' expectation is that some will look to Hong Kong as an attractive market," Hatherall added.

Wang said that the mobile payments services scene in Hong Kong is looking bright. He called 2017 the base year of mobile payments in Hong Kong as different kinds of mobile payment services such as Samsung Pay, WeChat Pay, and Alipay have emerged. "In 2017, Bank of China (Hong Kong) and WeChat Pay Hong Kong collaborated to promote local mobile payment usage in Hong Kong, offering customers faster and simpler one-stop mobile consumption experiences. Collaborating with high-tech companies can help enhance customer experience and technological innovation. It also expands banks' customer acquisition channels and accelerates banks' transformation in the digital banking aspect, he concluded.

Hong Kong GDP annual growth rate



Source: tradingeconomics.com, Census and Statistics Department, Hong Kong