

A piggy bank and stacks of US dollar bills are the central visual elements. The piggy bank is a classic pig shape, and the stacks of bills are arranged in a way that suggests wealth and savings. The entire scene is set against a dark blue background with a subtle gradient.

# THE DUEL FOR DEPOSITS

CRAFTING A WINNING DEPOSIT STRATEGY FOR HONG KONG'S VIRTUAL BANKS

DECEMBER 2023

QUINLAN  
& ASSOCIATES

# EXECUTIVE SUMMARY

- Deposits represent a critical pillar of virtual banks' operations in Hong Kong, serving as the core foundation of their future growth. However, most players are facing major challenges around their deposit strategies; from needing to broaden and deepen their deposit base to putting their existing deposits to work.
  - **DEPOSIT BASE (“BREADTH”)**: Despite amassing a combined 2.1 million customers as of H1 2023, the rate of growth in virtual banks' customer base has been slowing. Moreover, a significant portion of customer accounts (55% on average) remain dormant, including many with zero balances. The annualised growth rate in virtual banks' deposits has slowed even more acutely than their customer count, with all 8 virtual banks capturing HKD 32.2 billion of customer deposits by H1 2023, representing just 0.2% of Hong Kong's deposit base.
  - **DEPOSIT SIZE (“DEPTH”)**: Average deposits per virtual bank customer fell by a whopping 47% from HKD 29,300 in 2020 to HKD 15,500 in H1 2023, lagging average customer deposits at traditional banks by a factor of 30x.
  - **DEPOSIT QUALITY (“STICKINESS”)**: Due to insufficient capabilities to satisfy diverse customer financial needs, ~70%+ of customer deposits leave virtual banks once their promotion periods end. Furthermore, few virtual banks have positioned themselves as customers' primary bank accounts, with ~85% of customers reluctant to consider switching their primary bank accounts to virtual banks.
  - **DEPOSIT USAGE (“MONETISATION”)**: Hong Kong's virtual banks lag other APAC jurisdictions in terms of their product and service offerings, hampering their ability to monetise customer deposits. In fact, only a handful of virtual banks offer insurance and wealth management solutions, important fee-based income sources that are fuelled by customer deposits. Moreover, despite rapid growth in their loan books, below-industry average loan-to-deposit ratios (“LDRs”) indicate virtual banks' balance sheets have yet to be fully optimised.
- To capture a greater share of deposits, Hong Kong's virtual banks have been increasing their time deposit rates (especially for longer-tenure time deposits, i.e. 1-year), but competition from local incumbents remains fierce.
- While increasing deposit interest rates is a step in the right direction, we believe virtual banks need to develop more holistic and differentiated deposit acquisition, activation, retention, and monetisation strategies across different customer life stages (e.g. university students, fresh graduates, mid-career professionals) if they are to ultimately succeed in the coming years, especially for younger-generation customers.

# THE IMPORTANCE OF DEPOSITS FOR VBs

## Key Takeaways

Customer deposits are vital for the success of Hong Kong's virtual banks for two key reasons:

### Powering Internal Capabilities

- Lending Products: support lending capacity (i.e. drive interest income)
- Fee-based Products: generate fee-based income (e.g. wealth, insurance, payments)

### Supporting External Perceptions

- Regulatory Requirements: allow virtual banks to meet reserve requirements
- Customer Reputation: signal security and trustworthiness to customers

Customer deposits also have two key advantages as a source of funding :

- Cheap: serve as the cheapest source of funding sitting atop the capital structure
- Safe: mitigate risks from relying on specific and / or alternative funding sources (e.g. wholesale) and enhance financial stability

## Deposits represent a critical pillar of a bank's operations and are a vital ingredient for Hong Kong's virtual banks ("VBs") on their quest to scale

### The Importance of Deposits for Virtual Banks

Overview

← INTERNAL CAPABILITY →

← EXTERNAL PERCEPTION →



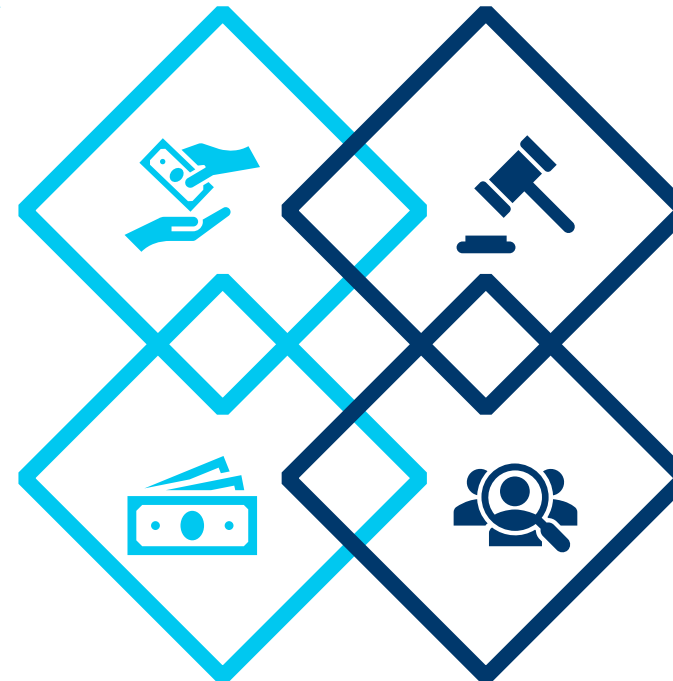
#### 1. LENDING PRODUCTS

Deposits serve as the foundation of VBs' balance sheet-led business, enabling them to lend to customers and generate interest income



#### 2. FEE-BASED PRODUCTS

Deposits also empower VBs to engage their depositors with fee-generating products (e.g. insurance, wealth management, etc.)



#### 3. REGULATORY REQUIREMENTS

Deposits enable VBs to meet reserve requirements, maintaining compliance and fostering confidence among regulators



#### 4. CUSTOMER REPUTATION

A large and stable deposit base signals to both current and prospective customers that VBs are secure and trustworthy

#### BENEFITS OF DEPOSITS...



#### CHEAP

Retail deposits represent the cheapest form of funding, positioned atop a bank's capital structure as the most senior unsecured funding



#### SAFE

Diverse customer deposits mitigate risks linked with dependency on specific and / or alternative funding sources and enhance a bank's financial stability

# VB DEPOSIT WOES – SUMMARY

## Key Takeaways

Hong Kong's virtual banks are currently facing four overarching challenges with respect to their deposit strategies:

### Deposit Base ("Breadth")

Virtual banks' rate of customer growth has slowed since their launch, with many accounts being dormant / zero-balance

### Deposit Size ("Depth")

Virtual banks hold just 0.2% of Hong Kong's total deposits, with average deposits per customer halving from 2020-H1 2023 to ~HKD 15,000

### Deposit Quality ("Stickiness")

Few customers choose virtual banks as their primary bank accounts, with many struggling to stem deposit outflows post-promotion

### Deposit Usage ("Monetisation")

Low LDRs indicate underutilised balance sheets, while the slow speed of product rollouts limits fee-based income potential

Hong Kong's virtual banks are facing key challenges around their deposit strategies; from needing to broaden and deepen their deposit base to putting their existing deposits to work

## Key Challenges for Hong Kong Virtual Bank Deposits

Overview



### DEPOSIT BASE ("Breadth")

*Slowdown in customer growth rate, with high dormancy / inactivity*

- Despite acquiring a combined ~2.1 million customers since their launch in 2020, the rate of growth in virtual banks' customer base has been showing signs of slowing
- Many customers at virtual banks remain dormant / inactive, including a sizeable number of customers maintaining zero-balance accounts



### DEPOSIT SIZE ("Depth")

*Ongoing decline in average deposit per customer account*

- The combined deposit base of virtual banks accounts for just 0.2% of all customer deposits in Hong Kong
- Hong Kong's virtual banks have seen their average deposit per customer account continue to decline since their launch, halving in size from 2020 (~HKD 29,000) to H1 2023 (~HKD 15,000)



### DEPOSIT QUALITY ("Stickiness")

*Inability to consistently retain deposits as secondary accounts*

- Few customers use virtual banks as their primary bank (especially for their payrolls), reflecting insufficient product / service offerings to address key household financial demands, including investments / savings
- Up to 70% of customer deposits are withdrawn from virtual banks once deposit promotion periods expire



### DEPOSIT USAGE ("Monetisation")

*Lending activity and fee-based income growth are lagging*

- The modest speed of new product rollouts (e.g. wealth) has inhibited the ability of virtual banks to leverage deposits to drive fee-based income
- While virtual bank loan books have grown rapidly in recent years, below-industry average loan-to-deposit ratios ("LDRs") indicate their balance sheets are yet to be fully optimised

# 1. DEPOSIT BASE (“BREADTH”) (1/2)

## Key Takeaways

Hong Kong’s virtual banks have rapidly expanded their customer base in recent years, amassing a combined 2.1 million retail and SME customers by H1 2023.

However, annualised growth rates have been decelerating each year since their launch – from 200% y/y in 2021 to just 28% y/y in 2023.

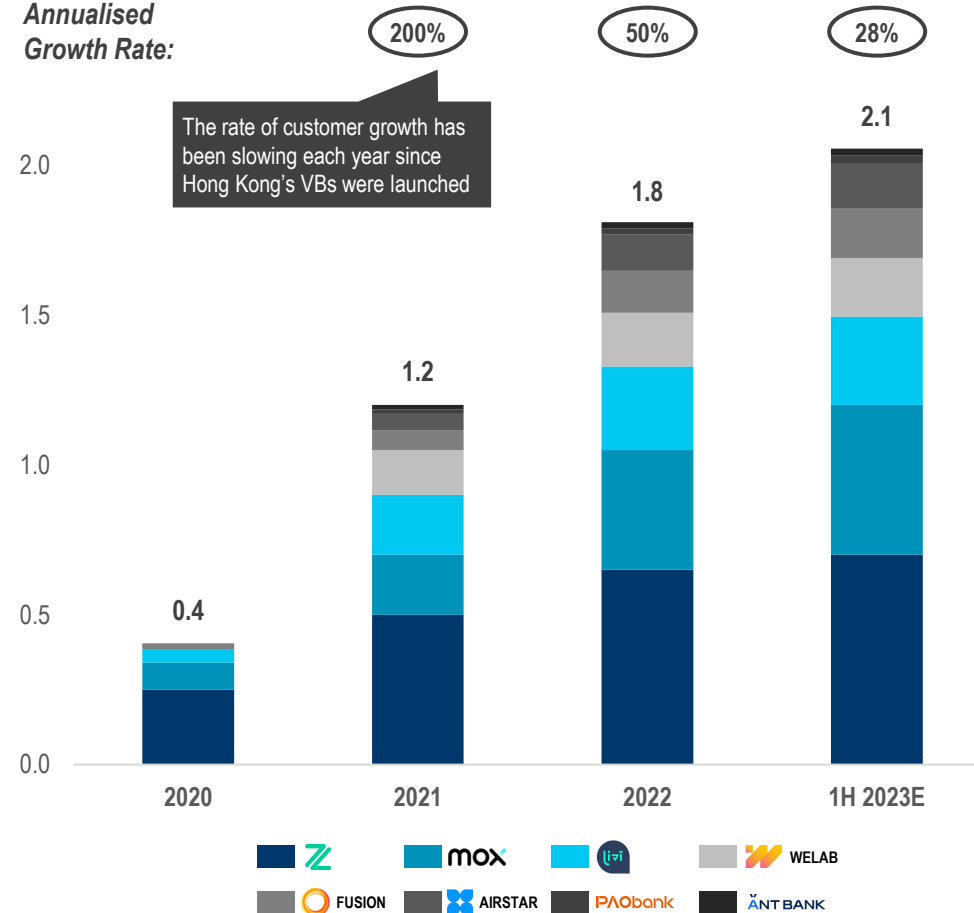
More importantly, many virtual bank customers remain inactive, with between 40-80% of accounts being dormant (i.e. customers do not log in to their account at least once per month). A sizeable number of these customers also maintain zero-balance accounts.

Despite amassing a combined 2.1 million customers as of H1 2023, the rate of growth in virtual banks’ customer base has been slowing, with account dormancy being a key problem

### Virtual Bank Customer Base\*

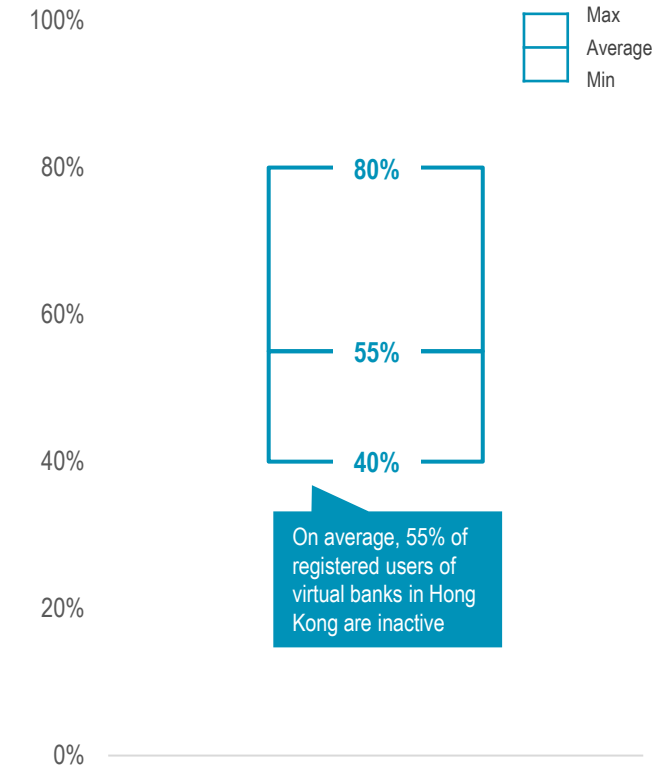
# Million, 2020-H1 2023E

Annualised Growth Rate:



### Customer Dormancy Rate\*\*

Hong Kong Virtual Banks, 2022E



Over half of the total customer base at Hong Kong’s virtual banks is dormant, including a sizeable number of customers with zero-balance accounts

\*includes retail and SME customers \*\*a dormant account is one in which a customer does not log in at least once per month

Source: Bank annual reports, Bank interviews, Quinlan & Associates analysis

# 1. DEPOSIT BASE (“BREADTH”) (2/2)

## Key Takeaways

The rate of growth in virtual banks’ customer deposits has been even more lacklustre than their customer base.

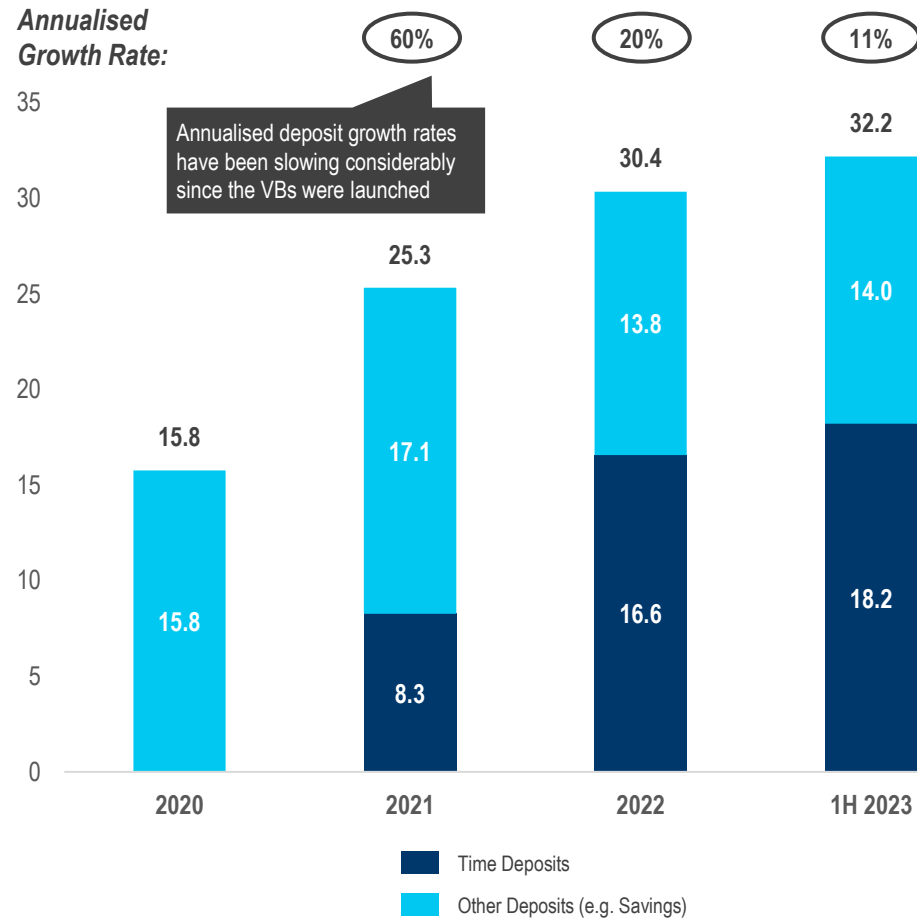
The combined deposit base of all 8 virtual banks doubled from HKD 15.8 billion in 2020 to HKD 32.2 billion in H1 2023 (vs. 5x growth in virtual banks’ customer count over the same period).

Against a backdrop of rising interest rates, the share of virtual banks’ time deposit holdings has also increased, representing 57% of their total deposits in H1 2023 (up from 33% in 2021).

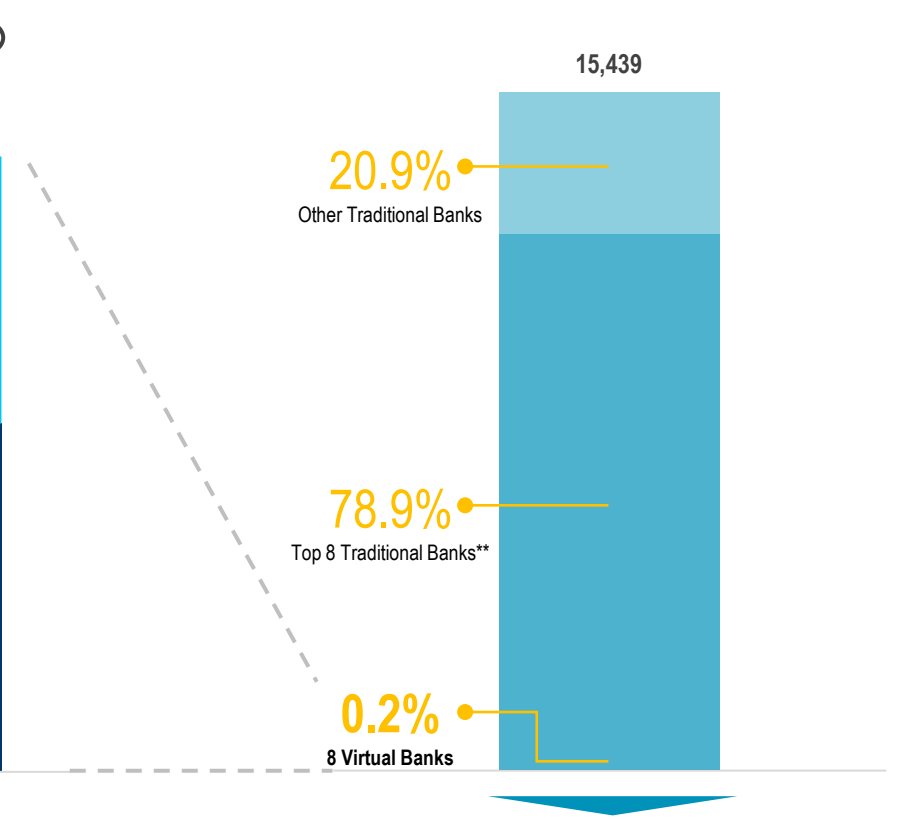
Following ~3 years of operations, the combined deposit base of Hong Kong’s virtual banks represents just 0.2% of the city’s HKD 15.4 trillion in total customer deposits.

The annualised growth rate in virtual banks’ deposits has slowed even more sharply, with all 8 virtual banks capturing just 0.2% of Hong Kong’s total customer deposits by H1 2023

**Virtual Bank Customer Deposit\***  
HKD Billion, 2020-H1 2023



**Hong Kong Deposit Market Share\***  
HKD Billion, H1 2023



*While virtual banks have amassed a large customer base (i.e. 28% of Hong Kong’s total population), they capture just 0.2% of the city’s total customer deposits*

\*includes retail and corporate customers, \*\*by asset size  
Source: Bank annual reports, HKMA, Quinlan & Associates analysis



## 2. DEPOSIT SIZE ("DEPTH")

### Key Takeaways

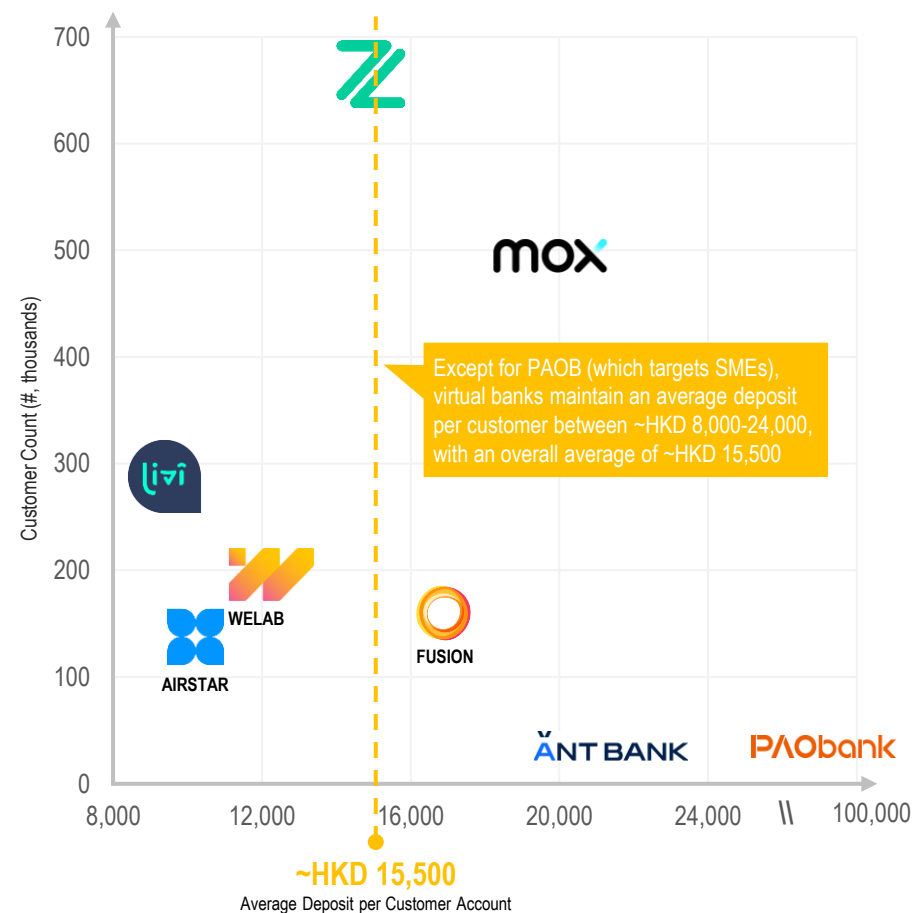
In addition to a small total customer deposit base, average deposits per virtual bank customer account remain modest, ranging from HKD 8,000-24,000 (excluding PAOB, which targets SME customers).

More importantly, the average deposit per customer has fallen from HKD 29,300 in 2020 to just HKD 15,500 in H1 2023, lagging traditional banks by a factor of 30x.

The average deposit per customer account at virtual banks has been declining every year since their launch, lagging traditional banks by a factor of 30x

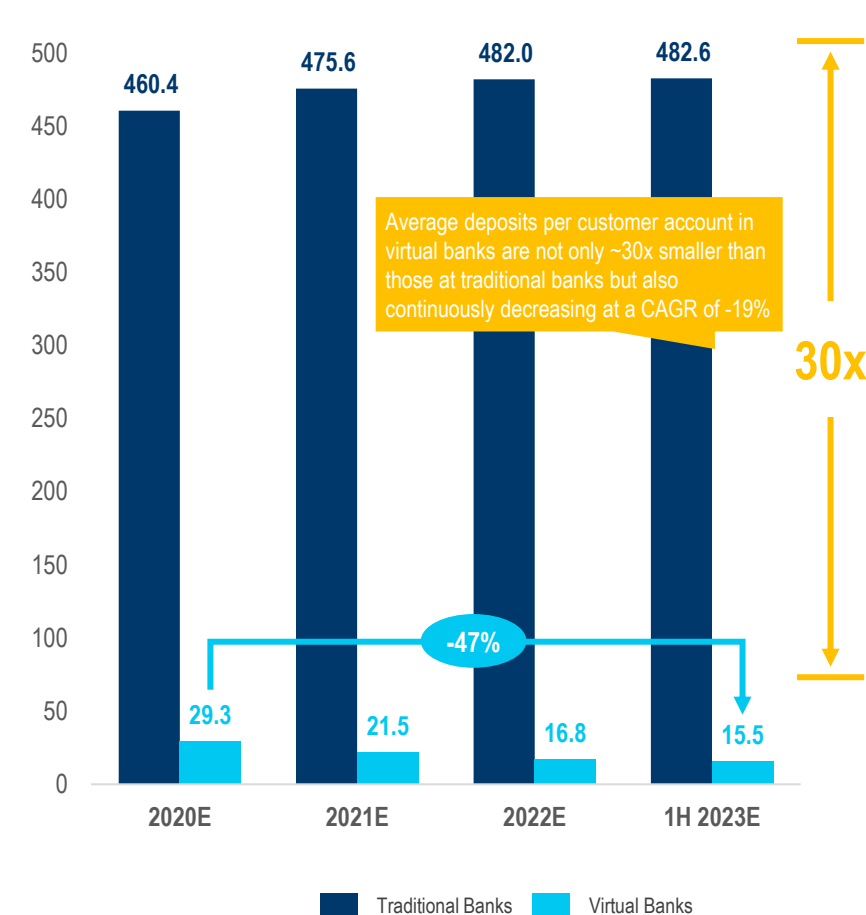
### Average Customer Deposits at Virtual Banks

Customer Count (#, thousands) vs. Deposit per Customer Account (HKD), H1 2023E



### Average Deposit per Customer Account

Thousand HKD, Virtual Banks vs. Traditional Banks\*, 2020E-H1 2023E



\*For traditional banks, only retail customer / personal deposits are considered

Source: Bank annual reports, HKMA, Census and Statistics Department, The World Bank, Quinlan & Associates analysis



### 3. DEPOSIT QUALITY ("STICKINESS")

#### Key Takeaways

Virtual banks face a number of challenges in satisfying a broad range of household financial demands, particularly with respect to mortgage repayments (32% of an average Hong Kong household's income allocation) and more comprehensive savings and investment needs (21% of an average Hong Kong household's income allocation).

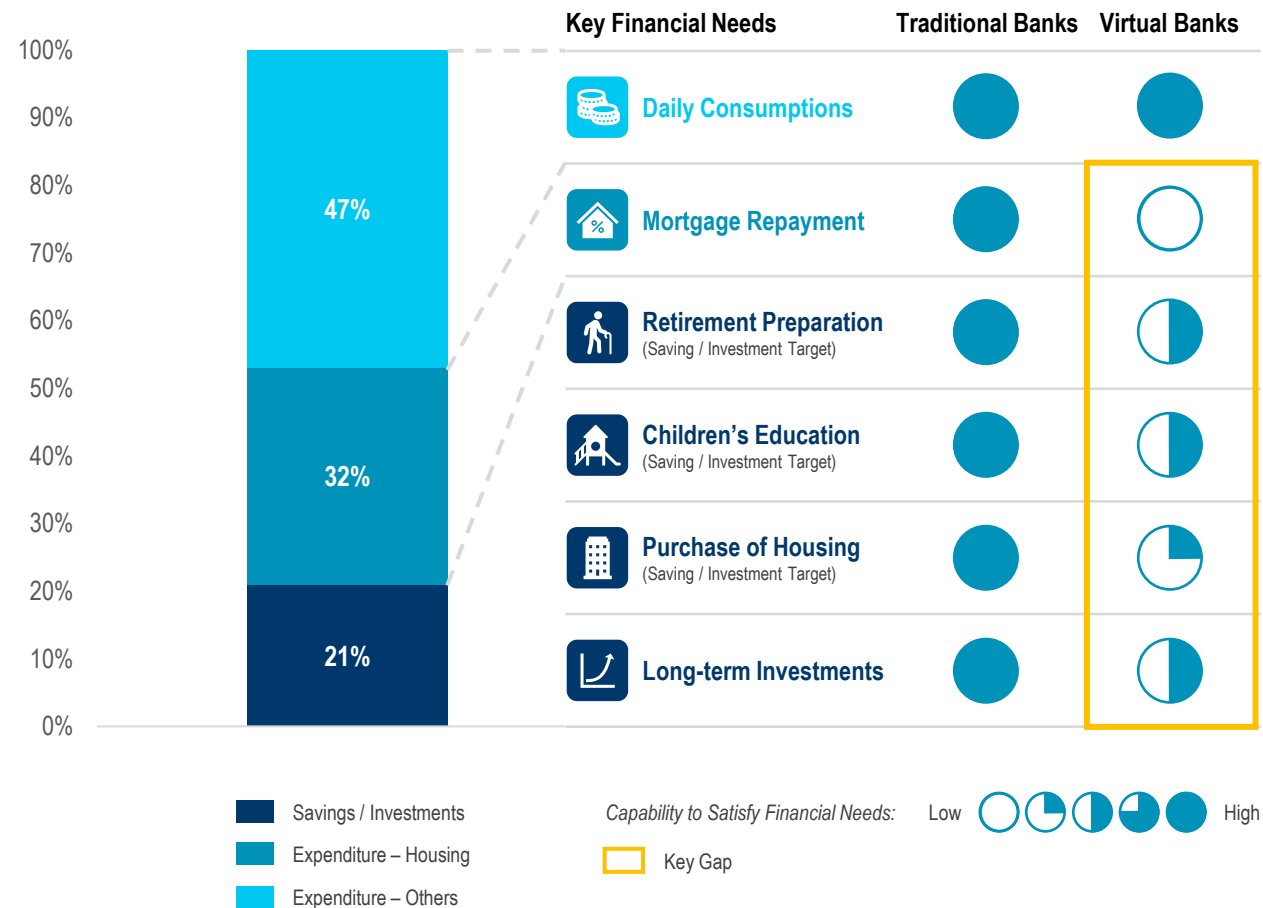
Given their comparatively limited offerings, Hong Kong's virtual banks have struggled to establish themselves as customers' primary bank accounts. As a result, 70%+ of customer deposits are transferred back to customers' primary bank accounts once deposit promotion periods end.

Looking forward, the vast majority (85%) of customers in Hong Kong are not willing to consider switching to a virtual bank as their primary bank account.

Virtual banks have struggled to establish themselves as the primary bank accounts for Hong Kong customers, resulting in considerable deposit attrition

#### Allocation of Household Income & Financial Needs

%, 2022E, Hong Kong Household Average



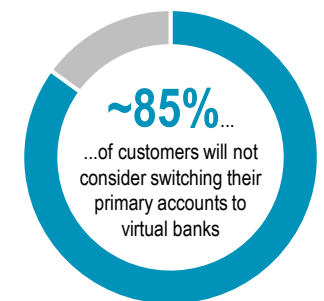
#### Major Hurdles for Virtual Banks

%, 2022E

*Insufficient capabilities to address customers' financial demands has led to sizeable deposit attrition...*



*...hindering virtual banks from becoming customers' primary accounts, impacting long-term revenue generation:*







## 4. DEPOSIT USAGE ("MONETISATION") (1/3)

### Key Takeaways

Just as important as gathering customer deposits is the ability of virtual banks to monetise them via the provision of lending and fee-based solutions to their customers.

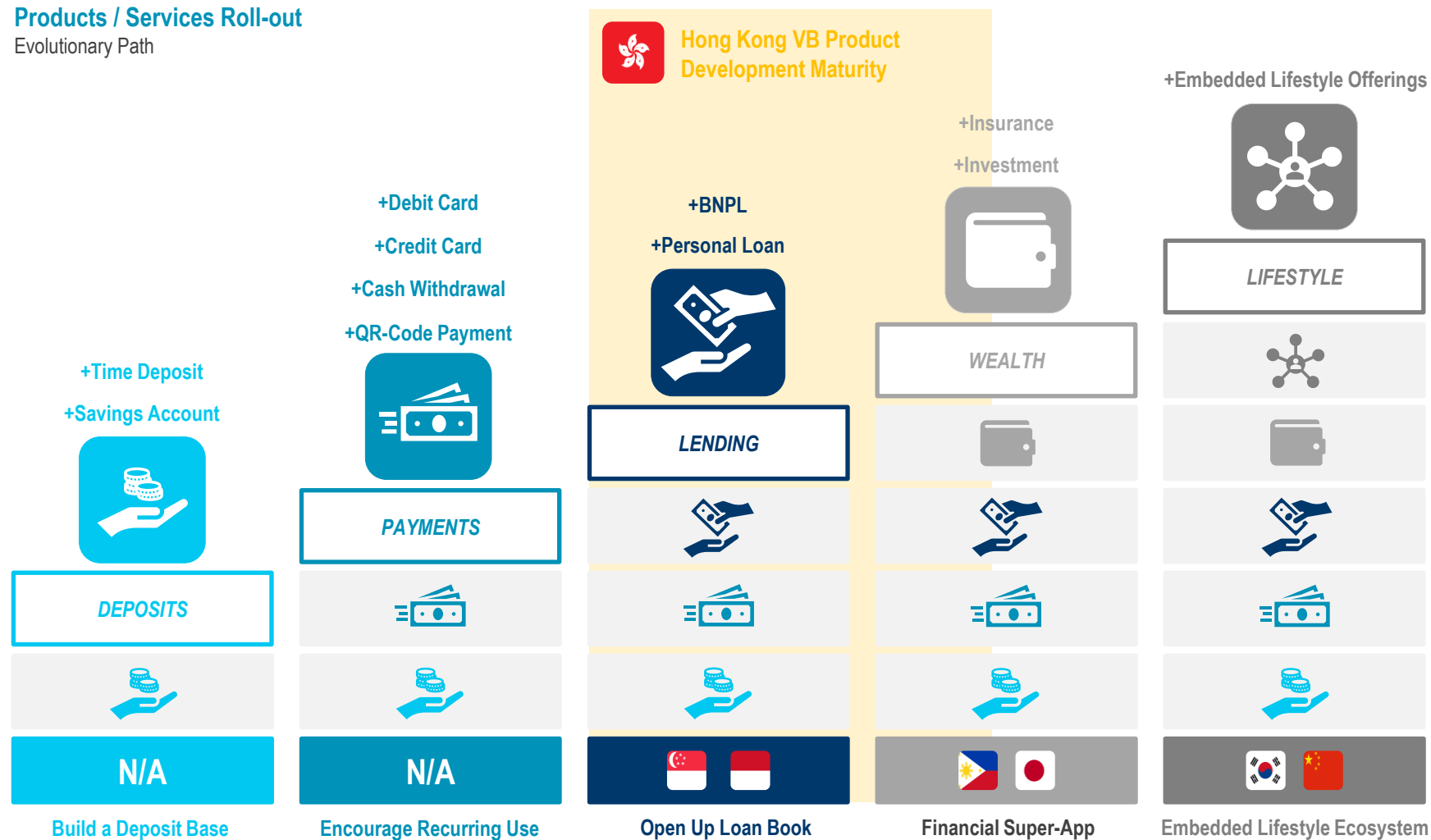
However, few virtual banks in Hong Kong have progressed meaningfully beyond offering relatively vanilla lending solutions.

More importantly, some of the lending solutions being offered by virtual banks, such as BNPL, are not well suited to the Hong Kong market, given customer preferences and poor unit economics attached to these models.

## Hong Kong's virtual banks lag other APAC jurisdictions in terms of their product and service offerings, hampering their ability to monetise customer deposits

### Products / Services Roll-out

Evolutionary Path



# 4. DEPOSIT USAGE (“MONETISATION”) (2/3)

## Key Takeaways

Taking a closer look at the product offerings of Hong Kong’s virtual banks, most remain limited to payments, lending, and FX services.

Only a handful of players have launched wealth management and insurance offerings, which allow virtual banks to funnel customer deposits into new fee-based income sources.

Moreover, no Hong Kong virtual bank currently offers embedded lifestyle solutions within their apps (e.g. movie bookings, restaurant reservations, flight and travel bookings).

Only a handful of virtual banks offer insurance and wealth management solutions, important fee-based income sources that are fuelled by customer deposits

### Retail Products / Services Hong Kong

Key Gaps Offered In Progress Not Offered

		RETAIL FOCUSED						SME FOCUSED	
		max						PAObank	ANT BANK
DEPOSIT	Savings Account	✓	✓	✓	✓	✓	✓	✓	✓
	Time Deposit	✓	✓	✓	✓	✓	✓	✓	×
PAYMENT	Online	✓	✓	✓	✓	✓	✓	✓	✓
	Offline	✓	×	✓	✓	✓	✓	✓	×
	Debit Card	✓	×	✓	×	✓	✓	×	×
	Credit Card	✓	×	×	×	×	×	×	×
LENDING	Personal Loan	✓	✓	✓	✓	✓	✓	×	✓
	PLGS <sup>1</sup>	×	×	×	×	×	✓	×	×
	Debt Consolidation	✓	×	✓	✓	✓	✓	×	×
	BNPL <sup>2</sup>	✓	✓	✓	×	✓	×	×	✓
INSURANCE	Life Insurance	-	×	-	×	✓	✓	×	×
	Health Insurance	-	×	-	×	×	✓	×	×
	Other Insurance	-	×	-	×	✓	✓	×	×
WEALTH	Discretionary Investment	×	×	×	×	×	✓*	×	×
	Non-Discretionary Investment	✓	✓	✓**	×	×	✓	×	×
OTHERS	Foreign Exchange	✓	✓	✓	✓	✓	✓	×	×
	Embedded Lifestyle Offerings	×	×	×	×	×	×	×	×

\*ZA Bank's IPOGo is a discretionary investment service, executing trades on behalf of customers; \*\*WeLab Bank's GoWealth Digital Wealth Advisory is a non-discretionary investment service requiring customer acceptance of recommendations, with monthly investments executed as per customer instructions; <sup>1</sup>Personal Loan Guarantee Scheme; <sup>2</sup>Buy Now Pay Later

Source: Bank websites, Quinlan & Associates analysis

# 4. DEPOSIT USAGE ("MONETISATION") (3/3)

## Key Takeaways

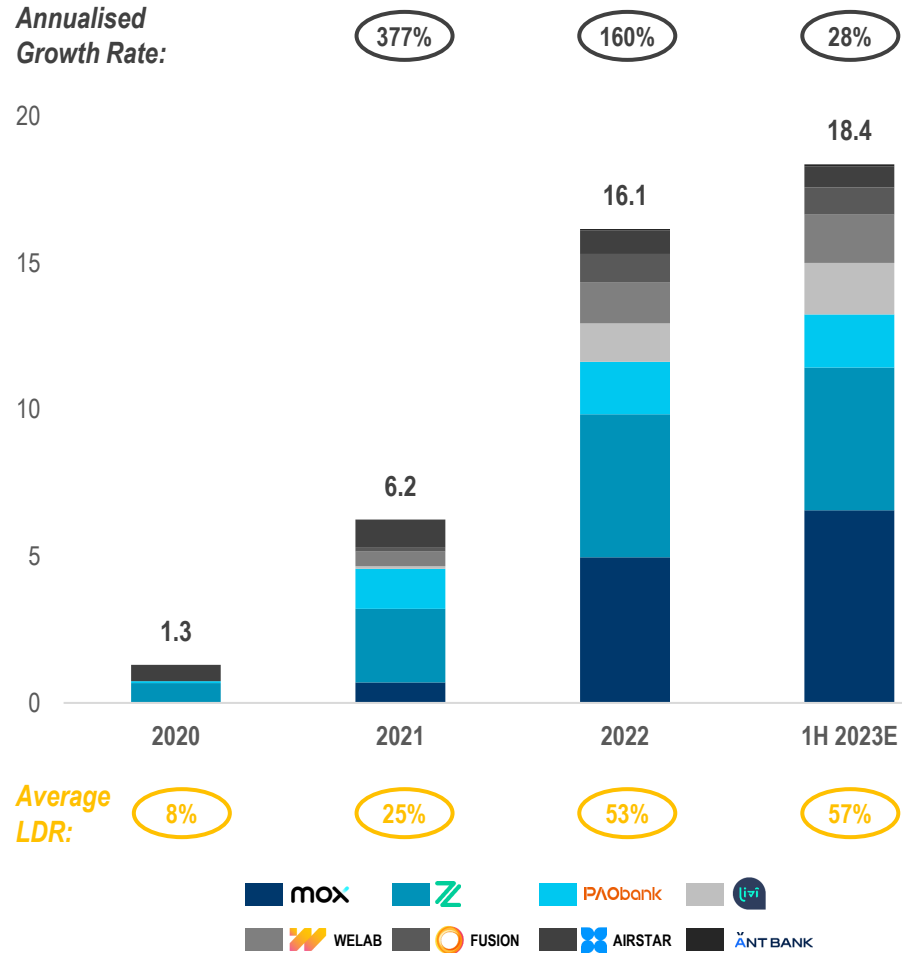
Over the past three years, Hong Kong's virtual banks have aggressively expanded their loan books, lending out HKD 18.4 billion by H1 2023.

Despite strong headline growth, the average loan-to-deposit ratio ("LDR") for Hong Kong's virtual banks stood at 57.0% by H1 2023, significantly below the 74.3% average LDR recorded by incumbent banking providers in Hong Kong, indicating that they have yet to fully optimise their balance sheets (i.e. their net interest margins).

Despite rapid growth in their loan books, below-industry average loan-to-deposit ratios ("LDRs") indicate virtual banks' balance sheets have yet to be fully optimised

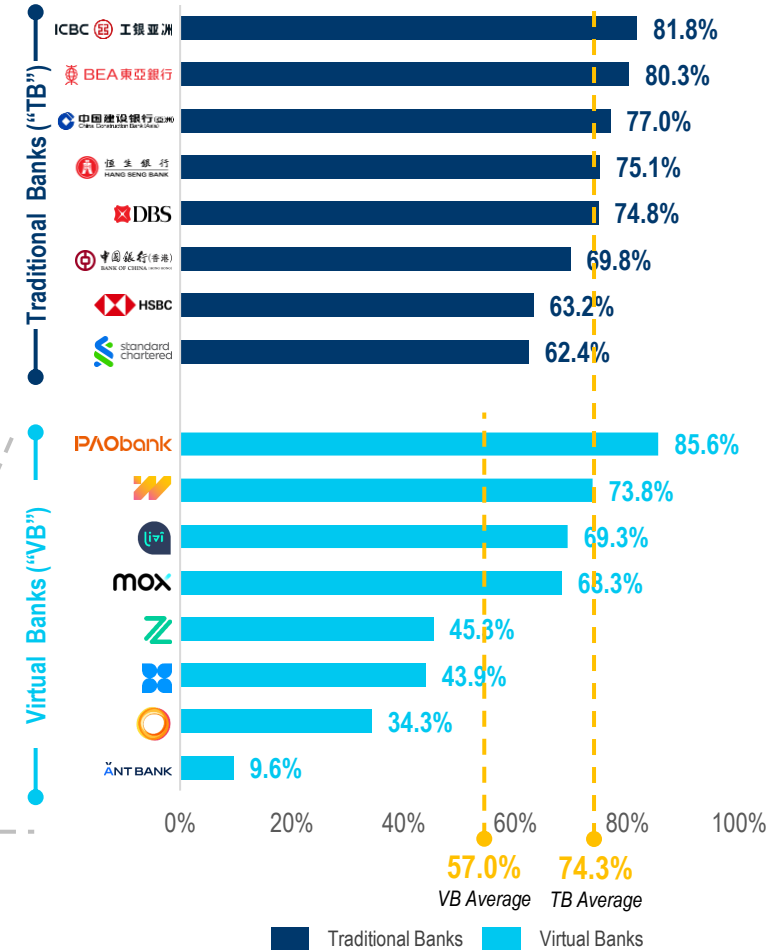
### Virtual Bank Loans to Customers

HKD Billion, %, 2020-H1 2023E



### Loan-to-Deposit Ratios ("LDRs")

%, H1 2023, Traditional Banks vs. Virtual Banks



# COMPETITION FOR DEPOSITS

## Key Takeaways

In the battle for deposit market share, both traditional and virtual banks have been increasing their time deposit rates (and promotional interest premiums) to entice new funds and customers.

However, competition remains fierce, while the approaches of traditional and virtual banks appear to differ:

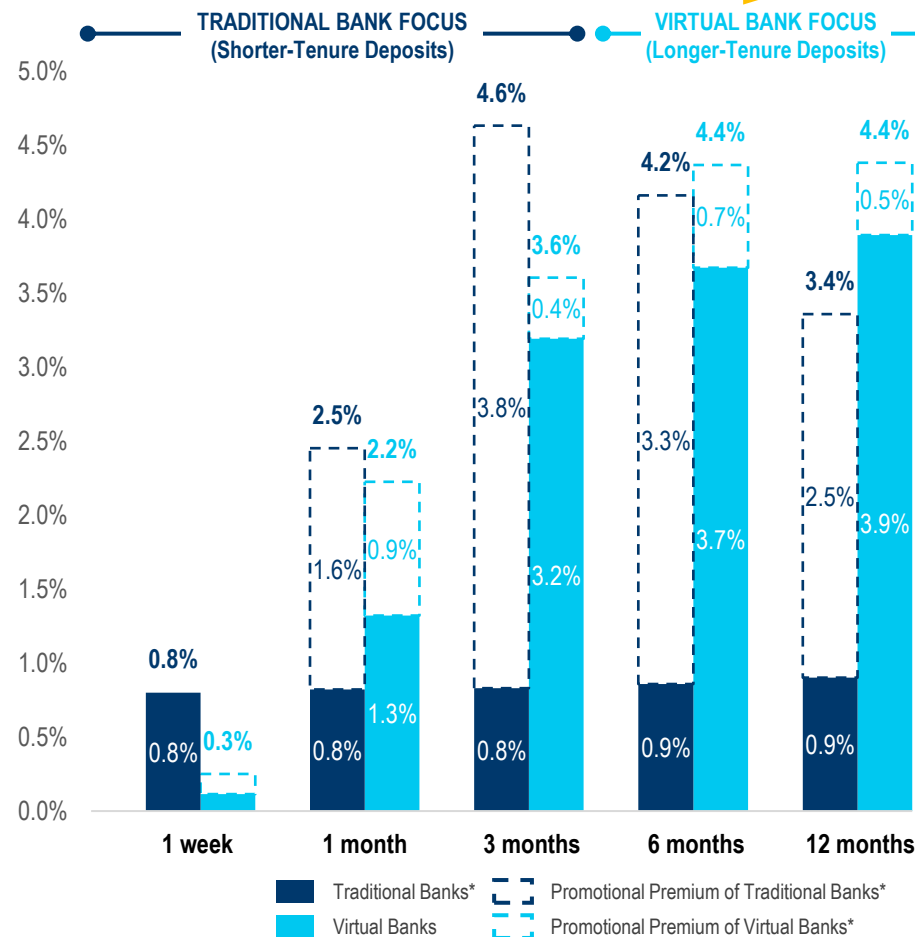
- **Traditional Banks:** have sought to attract new fund inflows by aggressively offering substantial premiums on their 1-month and 3-month time deposits for a limited promotional period.
- **Virtual Banks:** have been concentrating their efforts on cultivating a broader customer base with lower minimum deposit requirements, coupled with welcome offers for new customers.

To capture a greater share of deposits, Hong Kong's virtual banks have been increasing their time deposit rates, but competition from local incumbents remains fierce

## Average Time Deposit Interest Rates (by Tenure)

%, December 2023, Hong Kong

Many virtual banks are competing aggressively on rates, especially for longer-tenure deposits



\*only includes the top 8 traditional banks by asset size  
Source: Bank websites, Quinlan & Associates analysis

## Time Deposit Strategy Focus

% of Banks, HKD, Traditional Banks\* vs. Virtual Banks

### Ongoing New Fund Promotions



Traditional banks are seeking to attract new funds by offering interest premiums, specifically for time deposits opened with new funds from existing customers

### Ongoing New Customer Promotions



Instead of focusing on new funds from existing customers, most virtual banks have been offering premium savings rates as a welcome offer for new customers to the bank

### Ongoing Limited Time Promotions



Most promotional rates being offered by traditional banks come with a limited duration / offer period, encouraging customers to fund new deposits promptly

### Average Minimum Deposit (Base)



Virtual banks require significantly lower minimum deposits than traditional banks, enticing a broader range of long-tail customers to their deposit ecosystems

### Average Minimum Deposit (Promotion)



Virtual banks require lower minimum deposits to secure promotional rates than their traditional banking counterparts

# THE WAY FORWARD (1/2) – SEGMENTATION

## Key Takeaways

Virtual banks need to deploy unique strategies targeting customers at each of their life stages to address their ongoing deposit-related challenges:

### 1. Growth (e.g. university students)

While this segment has the least deposit potential, it can yield long-term dividends, with virtual banks ideally positioned for customer acquisition.

### 2. Exploration (e.g. fresh graduates)

Early-career professionals have yet to establish loyalty to a primary payroll account, and virtual banks can move early to capture this segment.

### 3. Establishment (e.g. mid-career professionals)

With the highest deposit potential, this segment typically requires a portfolio of financial products, which virtual banks should look to offer.

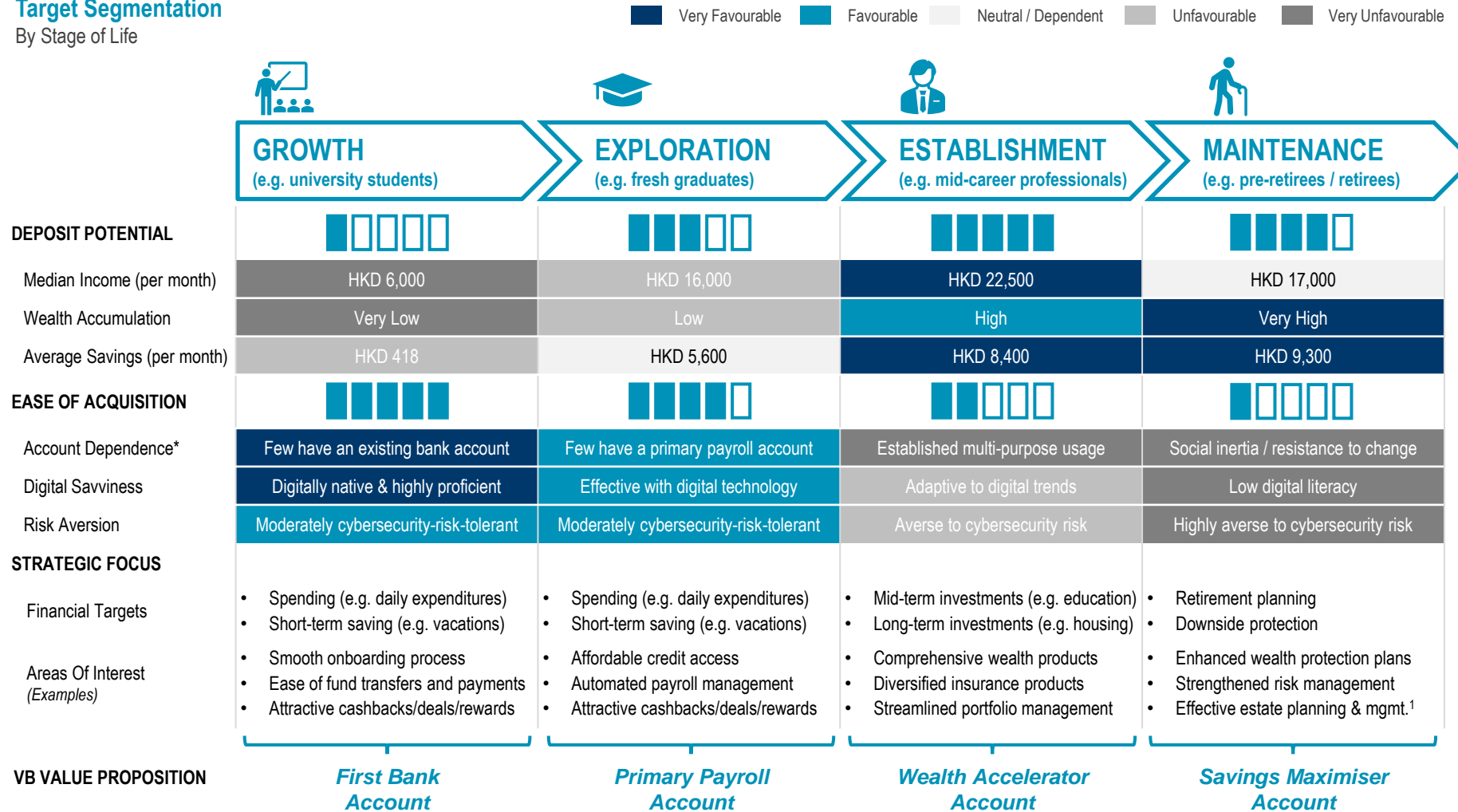
### 4. Maintenance (e.g. pre-retirees / retirees)

Targeting those with substantial wealth, a preference for savings, and inherent risk aversion, virtual banks need to focus on building secure and trusted solutions.

We believe virtual banks must develop more holistic and differentiated deposit acquisition, activation, retention, and monetisation strategies across different customer life stages

## Target Segmentation

By Stage of Life



\*Dependency on customers' existing accounts at traditional banks; <sup>1</sup>management

Source: Census and Statistics Department, Hong Kong Deposit Protection Board, Hong Kong Polytechnic University, Quinlan and Associates analysis

# THE WAY FORWARD (2/2) – KEY CONSIDERATIONS

## Key Takeaways

After identifying the characteristics of each customer segment, we believe Hong Kong’s virtual banks need to devise and implement a variety of strategic and tactical initiatives to scale the deposit size, fortify deposit loyalty, diversify deposit monetisation streams, and expand the overall ecosystem.

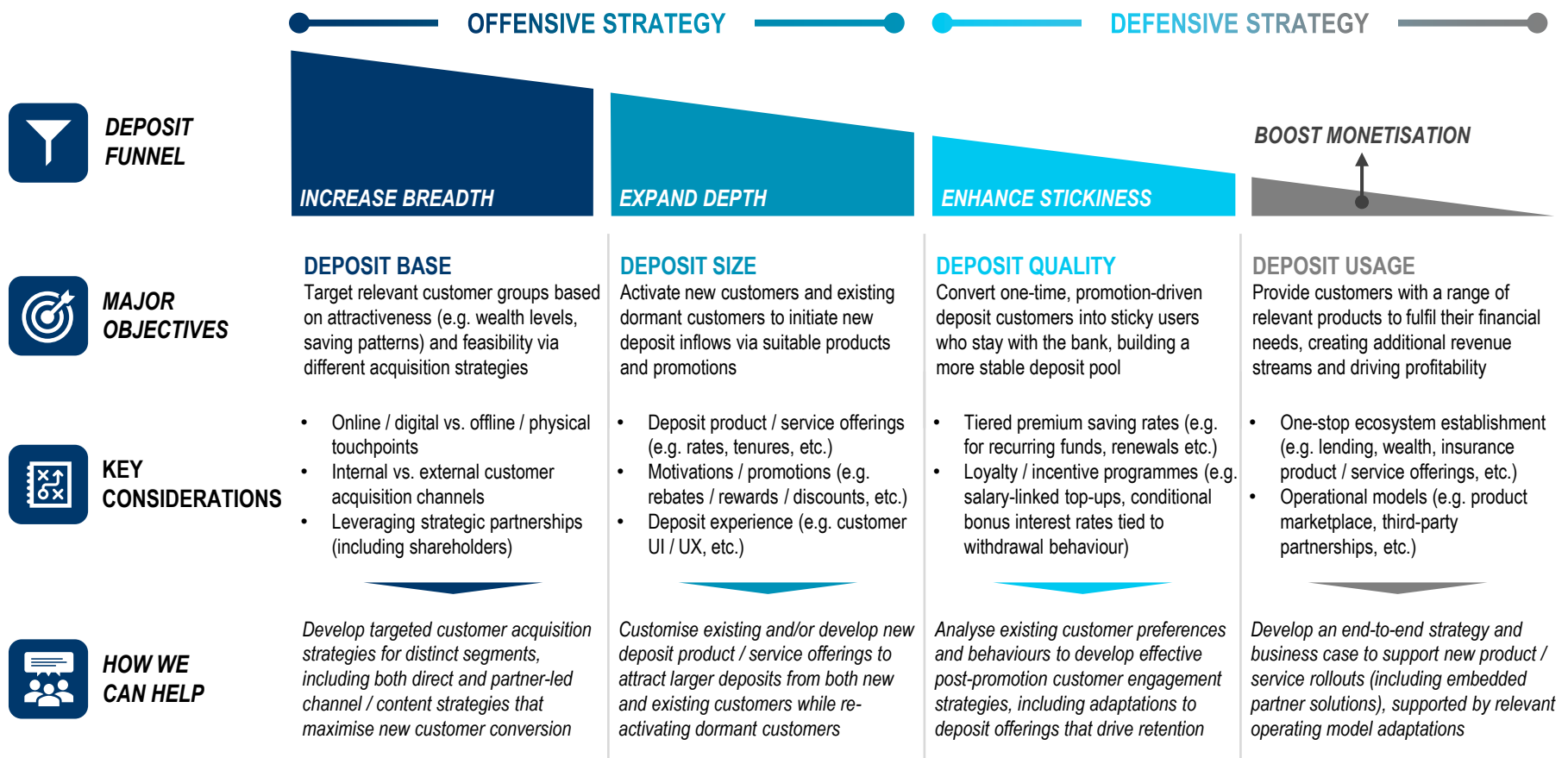
On the offensive front, emphasis should be placed on acquiring more attractive customer segments, as well as looking at strategies to attract new funds from existing customers.

On the defensive front, the considerable focus should be placed on strategies to limit deposit outflows while addressing a broader suite of existing customers’ financial demands through targeted product and service rollouts (both lending- and fee-led).

There are several key considerations that Hong Kong’s virtual banks must explore if they are to effectively build, retain, and monetise customer deposits in the coming years

## Key Considerations

Overview







STRATEGY WITH A DIFFERENCE

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