Feature

KEY POINTS
- Monetary Authority of Singapore (MAS) will issue up to five digital banking licences to applicants who may be of non-bank parentage – the first time it has been allowed.
- Licences would allow digital banks to provide banking services, as well as a whole range of other regulated types of financial services.
- The applicant group is expected to have a minimum three-year track record in operating a technology or e-commerce business.
- Focus on innovative and sustainable business models is likely to be key for prospective applicants.
- Risk management is also an important aspect of the application, and an exit plan in the event the banking business is wound down is also required.

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Digital disruption in Singapore: the new digital bank licensing framework

Following in the footsteps of other major financial centres, the Monetary Authority of Singapore (MAS) has announced that it will be issuing up to five new digital bank licences. This new regime marks the first time that applicants of non-bank parentage will be eligible to apply for a banking licence and is a significant step taken by the MAS towards further liberalising Singapore's banking sector. This article outlines the key features of this regime and the key issues and practical considerations that will need to be tackled for non-bank players seeking to disrupt such traditional players.

FULL v WHOLESALE DIGITAL BANKS

The five new digital bank licences to be issued by the MAS will comprise of two digital full bank licences and three digital wholesale bank licences. The main difference between these licences is that digital wholesale banks will not be permitted to serve retail customers.

As is expected, given the clientele restrictions imposed on digital wholesale banks, the eligibility criteria and other key requirements applicable to digital wholesale banks are slightly less onerous compared to that for digital full banks. In particular: (i) foreign controlled applicants may be considered for the digital wholesale bank licences, while applicants for the digital full bank licences must be controlled by Singaporeans and headquartered in Singapore; and (ii) the paid up capital requirement applicable to digital wholesale banks is only S$100m, compared to S$1.5bn for digital full banks. Other key ongoing requirements applicable to all banks generally, eg risk based capital requirements, apply equally to digital full and wholesale banks.

SINGAPOREAN CONTROL OF DIGITAL FULL BANK LICENCE APPLICANT

As noted above, applicants for a digital full bank licence must be controlled by Singaporeans. The MAS has indicated that an absolute majority stake held by a Singapore entity (or entities) is preferred to demonstrate such control.

However, the MAS has not shut the door on other alternative control structures and it may be possible for applicants to try to demonstrate to MAS that such Singaporean control exists despite the lack of a majority Singaporean shareholder. Such situations could include, for example, Singaporean control of the board or where the foreign shareholders involved have a strong connection to Singapore – such applicants should discuss such alternative structures with MAS as soon as possible to assess if their control structures are acceptable to MAS.

TRACK RECORD/VALUE PROPOSITION

One key requirement applicable to both digital full and wholesale bank licence applicants is that at least one entity in its group (ie itself or one of its controllers) must have a track record of at least three years in operating an existing business in the technology or e-commerce field – in particular, MAS expects such entity to bring "deployable technological capabilities" to the applicant.

This is related to another important factor which MAS will assess in the application, ie the applicant's proposal on how its business model can cater to unmet financial needs or underserved segments of the market, which is likely to be the key factor which will allow applicants to differentiate themselves. The type of track record and competencies of the applicant group should ideally be complementary to and support the proposals to be delivered by the applicant if it is successful.

It is important to note that MAS expects digital banks, with a lower cost structure and the ability to operate more nimbly, to be able to offer solutions not currently available from existing traditional banks – examples provided by the MAS include: offering deposit accounts without minimum deposit amounts or fall below fees, providing digital banking services which in turn allow small and medium enterprises to digitize their own operations, applying new technological approaches to credit risk assessment which in turn allows the digital bank to provide credit to under-served customer segments.

The manner and extent to which the digital bank can contribute to Singapore's growth as a global financial centre is also a key part of its value proposition. In this regard, the MAS' Financial Services Industry Transformation Map (FSITM) would be a valuable reference point on MAS' key areas of focus – in particular, the FSITM states that a key focus is "to facilitate pervasive innovation in the financial sector and encourage the adoption of technology for increasing efficiency and creating opportunity". Building a strong pool of local talent in the industry, particularly in information technology, is also a key objective set out in the FSITM and applicants which are able to commit to building up such specialised workforces locally will likely be viewed favourably.

SUSTAINABILITY OF PROPOSED BUSINESS MODEL

While a key objective of the digital bank licensing regime is to encourage the use of technology to provide innovative new financial products and services which would benefit Singapore consumers, or to reach any under-served segments, MAS has indicated that the proposed business model must be sustainable, with a demonstrable path to profitability.

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It has even expressly said that applicants with financial projections that show an earlier break-even year would be considered favourably.

This makes it clear that financial soundness is still the foremost of the MAS' concerns, and that it will not allow digital banks to try to take market share via value destructive strategies. Applicants will need to strike a fine balance in formulating their financial projections (which must be submitted as part of the application) for MAS' consideration – on one hand, providing more optimistic financial projections may appear favourable, however the applicant should expect such projections to stand up to scrutiny when queried by the MAS. Applicants should also note that MAS does expect the proposed business plan submitted at the application stage to be implemented, although it acknowledges that the ability to meet financial projections may be affected by external factors beyond the applicant's control. Licensed digital banks would however be expected to engage with the MAS promptly if they expect to fall short of such projections.

COLLABORATIONS WITH NON-BANKS

It is likely that most applicants will be seeking to leverage on other non-banking parts of the businesses of their parent/shareholder groups – for example, marketing collaborations with, or provision of financial services to, merchants and end-customers on e-commerce platforms. It would be important for applicants to consider whether, and how, these collaborations may be structured for compliance within the anti-comingling requirements imposed on all licensed banks (including digital banks). Essentially, banks are not permitted to conduct non-financial businesses without the approval of MAS, save within certain strict parameters and with the requisite risk management processes in place. For most applicants new to the banking industry, such restrictions would likely be novel and it will be key for compliant structures to be put in place which still enable the digital bank to realise the full potential of such collaborations.

PROVISION OF OTHER TYPES OF FINANCIAL SERVICES

A licensed digital bank would also be permitted to carry on other types of activities regulated under other financial services related regimes, eg capital markets activities, financial advisory services, payment services. A licensed bank would be exempted from licensing requirements, but remain subject to the conduct of business rules, under most of these other regimes. As such, applicants can consider how this would allow them to extend the scope of their proposed business beyond deposit taking, loans and other typical banking services. The bank's digital platform may also be extended to such other types of services, eg provision of financial advice over digital platforms using automated algorithms/bots, offering e-wallets, online marketing of life insurance policies.

ACCESS TO CASH

Digital full bank applicants should note that they will not be permitted to operate any automated teller machines (ATMs) or cash deposit machines (CDM), neither will they be permitted to join any existing networks of ATMs and CDMs. It follows that digital full banks would need to come up with innovative solutions to accept electronic deposits from customers and to reduce or even eliminate their customers' need for cash, eg joining the existing EFTPOS network to allow customers access to cashback points at retail outlets.

RISK MANAGEMENT

It should come as no surprise that risk management is a key aspect that MAS will look at in assessing prospective applicants – indeed there is an entire section in the application form which is devoted to this area. MAS has stated that "applicants should demonstrate that it has good understanding of the risks arising from its proposed banking business, and has clear plans on how it will monitor and manage these risks". In this regard, three particular areas of focus (based on the application form) appear to be the management of money laundering and terrorism financing (ML/TF) risks, information technology and cyber risks, and outsourcing risks.

Focusing on ML/TF risks in particular, given the digital nature of the operations of a digital bank, any automated processes put in place for customer due diligence (particularly involving non-face to face verification), screening, ongoing monitoring and record keeping will need to be robust. Applicants should also note that MAS will require an independent validation on the adequacy of its risk management framework prior to commencement of operations.

EXIT PLAN

Given the novel and to a certain extent, experimental, nature of the business models likely to be implemented, MAS also requires applicants to formulate an exit plan which will set out how the digital bank will wind down its operations and exit the banking sector in an orderly manner, if commercial circumstances dictate or if MAS so directs. This is similar to resolution planning requirements which have been introduced for domestic systemically important banks in Singapore.

The areas to be covered in an exit plan should include: the factors which would trigger the exit and monitoring of such indicators, persons responsible for implementing the plan, planning for contingencies (including identification of potential liabilities and how these will be funded), a communications and engagement plan with regulators, customers and other stakeholders.

Applicants will undoubtedly be focused on showcasing the strength of their proposed businesses and how they are likely to succeed, and as such may be tempted to give less attention to exit planning. This may however be misguided as a thorough and well formulated exit plan would likely give MAS more comfort from a prudential perspective. This would also indirectly show MAS that the applicant understands the importance and risk posed by its banking business to the financial ecosystem at large, should it be granted the licence.

CONCLUSION

The introduction of digital banks into the local banking industry will likely cause disruption and trigger a wave of innovative products and services. This would however also introduce new types of risks to the banking system in Singapore, and it is clear that the management of such risks is a high priority for MAS. As such, the eventual successful applicants are likely to be the ones which have managed to balance both sides of the equation – providing a business plan with innovative solutions and a strong value proposition that also makes financial sense, while at the same time being able to put in place rigorous compliance and risk management processes which satisfy the MAS. ■