

## VIRTUAL BANKING – SINGAPORE PROPOSES NEW DIGITAL BANK FRAMEWORK

The Monetary Authority of Singapore (MAS) announced on 28 June 2019 that it will issue up to five new digital bank licences. This will allow non-bank players to enter the Singapore digital banking market. MAS expects to invite applications for these licences in August 2019 and will provide more details on the eligibility and admission criteria at that time.

We have set out in this briefing an overview of the proposed regulatory framework for digital banks in Singapore. Digital banks have already been set up in the United Kingdom (UK) and Hong Kong will soon see the launch of virtual banks. Some highlights of the Hong Kong and UK regimes are set out at the end of this briefing.

### THE LICENCES

The five new digital bank licences will comprise:

- up to two digital full bank licences, which allow licensees to provide a wide range of financial services and take deposits from retail customers; and
- up to three digital wholesale bank licences, which allow licensees to serve small and medium enterprises (SMEs) and other non-retail segments.

The new development is in addition to the existing internet banking framework for local banking groups, under which local banking groups are allowed to set up digital bank subsidiaries either on their own or with joint venture partners where the local banks retain control.

### RATIONALE

This move by MAS to issue digital bank licences is a step towards further liberalisation of the banking industry, in view of the ongoing digitalisation of finance. Allowing the entry of new digital players is intended to help:

- diversify and strengthen Singapore's banking system in the digital economy of the future;
- cater to underserved market segments using innovative business models and strong digital capabilities; and
- provide impetus for existing banks to continue augmenting the quality of their digital offerings.

### Key issues

- The MAS will introduce a digital bank framework running parallel to the existing framework for local banking groups to establish digital banks.
- The digital bank framework consists of a dual regime where different criteria apply to digital full banks and digital wholesale banks.
- As digital full banks will be allowed to serve retail customers, they will be subject to more onerous safeguards and restrictions as compared to digital wholesale banks.
- Digital full banks will have to undergo a two-stage phase-in process before qualifying as a fully functioning digital retail bank.

The restriction on the number of new licences (in particular, in relation to digital full banks) has been imposed as MAS intends to retain a strong local core in the Singapore banking system, so as not to fragment Singapore's domestic retail banking market. MAS is also mindful of avoiding an unintended unilateral liberalisation of the full bank regime in Singapore, as a result of its World Trade Organisation commitments. The desire to ensure high-quality applicants and mitigate the risk of untested business models and cost of any failures has shaped the baseline requirements of, and safeguards imposed under, the new digital bank framework.

## **APPLICATION CRITERIA**

### **Digital Full Bank**

MAS will restrict the new digital full bank licences to applicants anchored in Singapore.

Applicants for a digital full bank licence must be companies headquartered in Singapore and controlled by Singaporeans. Foreign companies are eligible if they form a joint venture with a Singapore company, where the joint venture is headquartered in Singapore and majority controlled by Singaporeans. MAS will presume there is control if the Singaporeans and/or their related parties hold the largest shareholding and exert management control over the joint venture.

In addition, the applicant must:

- have a track record in operating an existing business in their respective technology or e-commerce fields;
- provide clear value propositions on how it can serve existing unmet or underserved needs; and
- demonstrate that it has a sustainable digital banking business model. MAS will assess the reasonableness of the applicant's business plans and financial projections such as cost-to-income ratio and net interest margin.

### **Digital Wholesale Bank**

The application for a digital wholesale bank licence is less restrictive. Applicants may be either Singapore or foreign companies. However, they will need to meet similar eligibility criteria (related to their track record and value propositions) as a digital full bank applicant.

## **SAFEGUARDS AND PHASING-IN OF PERMISSIBLE ACTIVITIES**

### **Digital Full Bank**

MAS will put in place safeguards with the aim of protecting depositors, mitigating the risk of untested business models and minimising costs to the financial system in the event of a failure.

As such, a digital full bank must be incorporated in Singapore and:

- participate in the Singapore deposit insurance scheme (which protects deposits of up to S\$75,000 per depositor in the event of the bank's failure);
- comply with the same suite of prudential rules as incumbent banks, including ongoing risk-based capital and liquidity requirements; and

- submit a viable exit plan to facilitate an orderly winding-up if necessary.

To minimise risks to retail depositors, MAS will phase-in the permissible activities of digital full banks via a two-stage process:

#### **First Stage: Restricted Digital Full Bank (Restricted DFB)**

A digital full bank will commence business as a Restricted DFB and be subject to the following restrictions in its initial one or two years:

- *deposit caps:*
  - aggregate deposits capped at S\$50 million;
  - individual's deposits capped at S\$75,000;
  - only accept deposits from a small group of persons such as business partners, staff and related parties;
- *business restrictions:*
  - only offer simple credit and investment products;
  - not permitted to offer complex investment products (such as structured notes) or engage in investment banking activities (such as derivatives) other than for risk management purposes and proprietary trading;
  - not permitted to establish banking operations in more than two overseas markets; and
- *low initial minimum paid-up capital of S\$15 million.*

Once the Restricted DFB has demonstrated good risk management, MAS will consider relaxing the deposit and business restrictions and will raise the minimum paid-up capital in proportion to its risk profile.

#### **Second Stage: Digital Full Bank**

The Restricted DFB will become a full functioning digital bank with all deposit caps lifted once it has met all relevant milestones and has been assessed to pose no significant supervisory concerns. The bank will need to meet a minimum paid-up capital requirement of S\$1.5 billion at that point.

In assessing the bank's readiness, MAS will consider factors such as the bank's business and financial performance, quality of loans, risk management and compliance track record, amongst others.

While MAS will not prescribe a time period within which the bank must graduate to become a full functioning digital bank, the Restricted DFB must have a viable plan to meet the requirements.

#### **Digital Wholesale Bank**

The restrictions imposed on digital wholesale banks are less onerous than that of digital full banks. A digital wholesale bank must be incorporated in Singapore and a viable exit plan must be submitted at the time of application.

The key requirements that a digital wholesale bank are subject to are:


- *minimum paid-up capital of S\$100 million;*
- *deposit restrictions:*
  - no Singapore dollar deposits from individuals, except for fixed deposits of at least S\$250,000;

- no restriction for business deposit accounts for SMEs and corporates;
- *capital and liquidity rules - same as existing wholesale banks; and*
- *business restrictions:*
  - only one physical place of business; and
  - may only conduct activities within the proposed business scope.

There is no phase-in process for digital wholesale banks.

## SUMMARY

The following table summarises the key requirements and restrictions of the digital full bank and wholesale bank frameworks.

	<b>Restricted Digital Full Bank</b> 			
	Entry Point	Progression	Digital Full Bank	Digital Wholesale Bank
<b>Minimum paid-up capital</b>	<b>S\$15 million</b>	<b>To progressively increase</b>	<b>S\$1.5 billion</b>	<b>S\$100 million</b>
<b>Deposit caps/ restrictions</b>	<b>Aggregate deposit cap:</b> S\$50 million deposits <i>Can accept deposits from limited scope of depositors only</i>  <b>Individual depositor cap:</b> S\$75,000	<b>Aggregate deposit cap:</b> To increase subject to meeting MAS' criteria  <b>Individual depositor cap:</b> S\$75,000	<b>No deposit cap</b>	<b>Individual deposits:</b> Only fixed deposit of at least S\$250,000  <b>SMEs and corporates:</b> Business deposit accounts permitted
	<b>Covered by Deposit Insurance Scheme</b>			
<b>Capital and liquidity rules</b>	<b>Capital:</b> Same as local banks <b>Liquidity:</b> 16% minimum liquid assets		Same as local banks	Same as existing wholesale banks
<b>Business restrictions</b>	Offer simple credit and investment products  Banking operations in not more than two overseas markets	No business restrictions after meeting MAS' criteria	Full functioning bank	Only conduct activities within the proposed business scope
	<b>One physical place of business only</b>			
	<ul style="list-style-type: none"> <li>• No minimum account balance or "fall below" service fees</li> <li>• Compliance with unsecured credit rules</li> <li>• Allowed to offer cashback services through electronic funds transfer at point of sale terminals at retail merchants, but no access to automated teller machines or cash deposit machine network</li> </ul>			

## DEVELOPMENTS IN HONG KONG AND THE UK

Hong Kong	The UK
<p>The Hong Kong Monetary Authority (HKMA) has welcomed the establishment of virtual banks (VBs) in Hong Kong and renewed the VB authorisation framework in 2018. HKMA to date has granted a total of eight VB licences and HKMA is now working closely with the eight VB licensees to prepare for the launch of their business operations in accordance with their plans each targeting to launch their services by Q4 2019 / Q1 2020.</p> <p>Similar to Singapore, the VB framework in Hong Kong is intended to promote the application of financial technology and innovation in Hong Kong, and financial inclusion, particularly for SMEs and retail segments. One key point to note is that under the renewed VB authorisation framework, both financial firms (including existing banks in Hong Kong) and non-financial firms (including technology companies) may apply to own and operate a VB in Hong Kong.</p> <p>There is no phasing-in process, or a "wholesale" route, for VBs in Hong Kong, unlike in Singapore. VBs will be subject to the same set of supervisory requirements applicable to conventional banks in Hong Kong, although some of these requirements will be adapted to suit the business models of VBs under a risk-based and technology-neutral approach.</p>	<p>The UK does not have a specific regime for virtual or digital banks. The Prudential Regulation Authority (PRA) and Financial Conduct Authority have a specific programme and dedicated division for the authorisation, operation and supervision of so-called "challenger banks", called the New Bank Start-up Unit (Unit). The Unit, launched in 2016, has been involved in the authorisation and supervision of a number of challenger banks, the majority of which are digital-first or digital-only banks. The Unit recently published its guidance for institutions considering becoming a bank.</p> <p>The aims of the Unit are to provide:</p> <ul style="list-style-type: none"><li>• <i>clarity</i> – the Unit will provide clarity regarding the PRA's bank authorisation process and expectations;</li><li>• <i>continuity</i> – the Unit will try to smooth the transition to becoming a supervised firm; and</li><li>• <i>support</i> – the Unit will help new banks establish themselves in the market.</li></ul> <p>In the UK (as is the case more broadly in the European Union), certain banking-like activities may be performed by other types of authorised entities. For example, entities licensed as payment institutions or electronic money institutions may execute payment transactions and issue payment cards. Such entities cannot accept deposits and may be more limited in certain other activities. Seeking authorisation as a payment institution or an electronic money institution may be regarded as a "stepping-stone" to obtaining a full banking licence, and is a route that some digital banks have taken.</p>

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