

How COVID-19 will affect digital banking in Malaysia



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As Bank Negara Malaysia extends its digital banking framework deadlines, how can applicants use the time to maximize their chances of being one of the license recipients when the crisis recedes?

In the wake of the COVID-19 pandemic, Bank Negara Malaysia (BNM) has announced that the deadline to respond to consultation papers on the digital banking licensing framework has been extended to 30 June 2020 and possibly beyond.

However, while the current crisis will almost certainly delay the award of licenses in Malaysia, it also highlights the importance of digital and social-distant banking. When Malaysia's economy begins its post-pandemic rebuild, digital financial services will be a high priority to help the economy recover.

The current situation

BNM is proposing to issue up to five licenses to qualified applicants to establish digital banks that conduct either a conventional or Islamic banking business. Before the crisis, prospective applicants included technology players, gaming firms, telcos and ride-hailing groups.¹

With deadlines being extended before the final shape of the licensing framework is confirmed, those still in the race have more time to consider how to shape their application.

In a post COVID-19 world, what will they need to win?

Entry-level qualifications

To get through the first round of screening, applicants must be able to demonstrate:

- ▶ **Financial inclusion** – BNM's framework has always aimed to drive financial inclusion. Given the economic burden of the current crisis, this feature will likely be front and center of application considerations. Applicants therefore need to show a central commitment to driving financial inclusion, including offering meaningful access and responsible, affordable financial solutions. BNM is looking for product strategies that meet the needs of the underserved and unserved banking segments, especially the poor. BNM is likely to be particularly

interested in value propositions from non-bank applicants that address niche market needs.

- ▶ **Capital strength** – to safeguard the integrity and stability of Malaysia's financial system in a time of economic challenges amid COVID-19, applicants will need capital funds of minimum RM100m in the foundational phase and RM300m thereafter.
- ▶ **Financial viability** – this includes maintaining an asset threshold of no more than RM2b in the first three to five years.
- ▶ **Regulatory compliance** – applicants must comply with the Financial Services Act (FSA) and Islamic Financial Services Act (IFSA) regulations, with simplified regulatory requirements in the "Foundational" phase.

But these are just table stakes. To win a digital banking license, applicants must convince BNM they come with:

A winning strategy

BNM will expect a convincing strategic plan for the business to succeed in a changed social and economic environment. Applicants should include a detailed outline of their:

- ▶ **Business model** – BNM needs to know about target micro segments, particularly the poor and the unbanked, and plans for embedding products in a customer's daily life. It expects digital banks to encourage take-up by offering world-class customer experiences. Critical elements include simple products, pricing and transparency – and a high degree of personalization.
- ▶ **Technology** – BNM is looking for a configurable core banking architecture built on today's technology leading practices. Technology strategies should leverage cloud and APIs, and have a high degree of automation, AI and machine-learning. Technology should also support work from home.

1. "Exclusive: Grab, Razer, AirAsia exploring bids for Malaysia digital bank licence" *Reuters*. 22 January 2020. © Thomson Reuters 2020. Accessed 24 February 2020



- ▶ **Talent** – in this environment, the talent expectation is for a high proportion of engineers and design professionals working in multidisciplinary teams. Applicants will need to demonstrate they'll be capable of attracting this workforce, with a purpose-focused, socially-supportive culture and an employee value proposition targeted at entrepreneurs and millennials. Staff health and safety will be paramount.
- ▶ **Operations** – applicants will be expected to have no, or a limited, branch network, with mobile-only, virtual or robo-led services. The plan should be to work toward NoOps. This is where the IT environment becomes so automated and abstracted from the underlying infrastructure that the digital bank won't need a dedicated team to manage software in-house.

The right consortium with clearly articulated synergies

Applicants will almost certainly need to take a consortium approach, as no single party could claim to fulfil the six key capabilities required to launch a digital bank:

1. **Capital** – sufficient working capital and balance sheet for license acquisition and operational cost
2. **Customer and distribution** – ability to access a large customer base to distribute financial products
3. **Brand** – ability to engage consumers with seamless customer experiences that resonate with different target segments
4. **Banking technology and operations** – expertise in banking systems and day-to-day operations
5. **Risk management** – solid knowledge of systems, processes and experience to manage risks and regulatory reporting
6. **Financial product design** – ability to define and manufacture lending and investment products

It's unlikely that even incumbent banks will be able to go it alone. Sticking a digital end on current capabilities is unlikely to work. Institutions will need not just a digital front end, but a new technology stack to achieve the agility and speed-to-market required to succeed as a digital bank.

In partnership situations, BNM expects applicants to detail the value each member of the consortium brings. Consortiums will need a strong narrative targeting both BNM as well as the public around the digital bank's strategy, purpose, direction, viability and strength of partnership.

Credible shareholders

In a challenging economy, BNM will scrutinize an applicant's shareholders for their ability to continuously serve as a source of financial strength to the proposed licensed digital bank. BNM will also look favorably on shareholders who themselves have robust risk management and compliance capabilities, demonstrated by a track record of operating successfully in a regulated environment.

For Islamic digital banks, shareholders must possess the requisite Shariah expertise to effectively carry on an Islamic digital banking business.

Finally, BNM will be monitoring the digital licensing processes in Hong Kong or Singapore for learnings but winning there is no guarantee of a spot in Malaysia. Successful applicants must understand the interests of the Malaysian market post-crisis and adapt their strategies to meet these needs.

Summary

Malaysia's digital banking applicants should use the time extension to craft business models, technology and operations designed for a post-COVID-19 world. Financial inclusion, innovative technology and capital strength will be key.

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