ALLEN & OVERY

Digital banking licences in Singapore: MAS opens applications

September 2019

Executive summary

The Monetary Authority of Singapore (**MAS**) announced on 29 August 2019 that it will begin accepting applications for new digital bank licences.

This follows from its earlier announcement on 28 June 2019 of its intention to issue up to two digital full bank (**DFB**) licences and up to three digital wholesale bank (**DWB**) licences, which was discussed in our previous update, "MAS opens the door to digital banking".

Issued at the same time as MAS' announcement was (1) an accompanying application form, (2) a document setting out the Eligibility Criteria and Requirements for Digital Banks, and (3) a set of Frequently Asked Questions. These are available on the MAS' website.

All applications for a DFB or DWB licence must be submitted by 31 December 2019.

In this update, we breakdown the key assessment criteria and summarize the application and establishment timeline.

"The new digital bank licences will mark the next chapter in Singapore's banking liberalisation journey."

Mr Tharman Shanmugaratnam, Senior Minister and Chairman of MAS, at The Association of Banks in Singapore's Annual Dinner, on 28 June 2019

Examination of key eligibility and assessment criteria

Technology as a bedrock of the business

Given the nature of business the DFBs and DWBs are expected to carry on, technology is a key feature in the eligibility criteria released by the MAS. In particular, applicants will need to demonstrate:

Technology or e-commerce track record

The applicant or at least one entity in the applicant group must have at least three or more years in operating an existing business in the technology or e-commerce field. Examples of these include those engaged in developing financial technology, advanced data analytics, machine learning, artificial intelligence, as well as those which operate digital platforms (including those which facilitate the delivery or integration of financial services) and provide telecommunication services.

Technology as a clear feature of the DFB's/DWB's value proposition

The business model of the applicant is expected to incorporate the innovative use of technology to serve unmet customer needs and reach under-served segments of the Singapore market. The applicant's ability to contribute to the growth of Singapore as a global financial centre will also be taken into consideration.

It would, in our view, be important to for applicants to show:

How it will **utilize technology to differentiate its business from existing market players.** The MAS has suggested that the use of new technology stacks may result in a lower cost structure, and digital banks may also utilise a wider variety of data sources in order to expand its lending target markets.

Its investment in a **strong local pipeline of specialised talent** in the technological and e-commerce field.

How it will **facilitate and invest in research and development to develop new technological solutions** and how it will **harness technology to simplify and enhance regulatory compliance.**

Singaporean control of DFBs

Both DFBs and DWBs will need to be incorporated in Singapore.

Specifically for DFBs, **the MAS will only consider applicants that are anchored and headquartered in Singapore and controlled by Singaporeans.**

In assessing whether the proposed DFB is "controlled" by Singaporeans, the MAS will consider whether:

– the proposed DFB and its parent entity publicly identify Singapore as their home country;

– the parent entity's global head office is in Singapore; and

– effective management of the parent entity and the proposed DFB are in Singapore.

Where there is no parent entity, the MAS will consider whether a Singaporean individual or a Singapore entity which fulfils these conditions, together with its related parties similarly meeting these conditions, holds in aggregate the single largest shareholding and has effective control over the proposed DFB.

This does not mean that the MAS will only consider DFB applicants that are wholly Singaporean – the MAS has noted that **joint ventures may be acceptable** (which was a common approach taken by applicants for virtual bank licences in Hong Kong).

Foreign companies seeking to apply for a DFB licence by way of a joint venture will need demonstrate Singaporean control by meeting these requirements:

– the foreign company must form a joint venture with at least one local company;

– the joint venture must meet the requirements of being anchored in Singapore, controlled by Singaporeans and headquartered in Singapore; and

– an absolute majority stake in that joint venture entity should ideally be taken by a Singapore entity and its related parties, as MAS has stated that this is a clear demonstration of control by Singaporeans.

If a Singapore entity and its related parties do not have an absolute majority stake, consultation with the MAS is recommended prior to the submission of the licence, and the MAS will only consider such cases on an exceptional basis. The expectation thus would be for the applicant to demonstrate that there are other factors that meet the criterion for Singaporean control. In this instance, in addition to considering the nationality and profile of the other shareholders, the MAS will also consider broader arrangements such as board nomination and control.

The Singaporean control element is in sync with the board composition requirements to be imposed on DFBs, where the MAS has clearly stated that it will expect a majority of directors to be Singaporeans or permanent residents of Singapore from the commencement of operations.

Other requirements

Amongst various value proposition requirements and the ability to meet the eligibility criteria that should be demonstrated in the application, the following crucial points must be noted:

At the time of application, the applicant for the DFB or DWB should have already hired its prospective Chief Executive Officer.

At the time of application, candidates for the positions of Chief Risk Officer, Chief Finance Offer, Chief Technology Officer and Chief Information Security Officer must already be identified and ready to be recruited. The MAS has stated that it will allow the applicant to share selected executive officers (such as the Chief Technology Officer) with its parent or affiliates during the restricted phase.

Every shareholder that directly holds at least 20% of the proposed digital bank's shares will need to provide a written confirmation at the point of application that it commits to providing a letter of responsibility and a letter of undertaking in respect of the operations of the proposed digital bank.

Letter of responsibility: Sets out the responsibilities of the parent or significant shareholders of the applicant, including: accepting full responsibility for the operations of the digital bank, ensuring that the digital bank maintains sound liquidity and financial position at all times, and providing adequate funds to make up for any liquidity shortfall of the digital bank.

– **Letter of undertaking:** Sets out that the parent and/or significant shareholders of the applicant will undertake to meet any outstanding non-bank deposit liabilities in the event of an exit.

A DFB applicant must be able to demonstrate its ability to meet the applicable minimum paid-up capital requirement at the onset and the minimum capital funds requirement on an on-going basis. This must include commitment of funds or concrete fundraising plans to meet the minimum paid-up capital of SGD1.5 billion that is required when it becomes a fully-functioning DFB.

Ongoing supervision and compliance

Digital banks will be subject to the same compliance and regulatory requirements as existing banks.

As anticipated in our earlier update "MAS opens the door to digital banking", the MAS has confirmed that digital banks will be subject to the same compliance and regulatory requirements as existing banks.

Crucially, this will include risk-based capital requirements: the MAS has indicated that a DFB will be subject to the **same level of risk-based capital requirement as a domestic systemically-important bank** even though a DFB will not be designated as such at the onset. The MAS has explained that it imposed a higher risk-based capital requirement[1] on DFBs as their business models are untested.

While not expressly dealt with in the Eligibility Criteria and Requirements for Digital Banks and in the Frequently Asked Questions, the MAS will also be expecting applicants to be able to **demonstrate their ability to ensure compliance with the banking regulatory framework.** The application form therefore requires applicants to set out:

– a proposed risk management framework;

– a framework for dealing with key money laundering and terrorism financing risks; and

– a framework for technology risk management and business continuity.

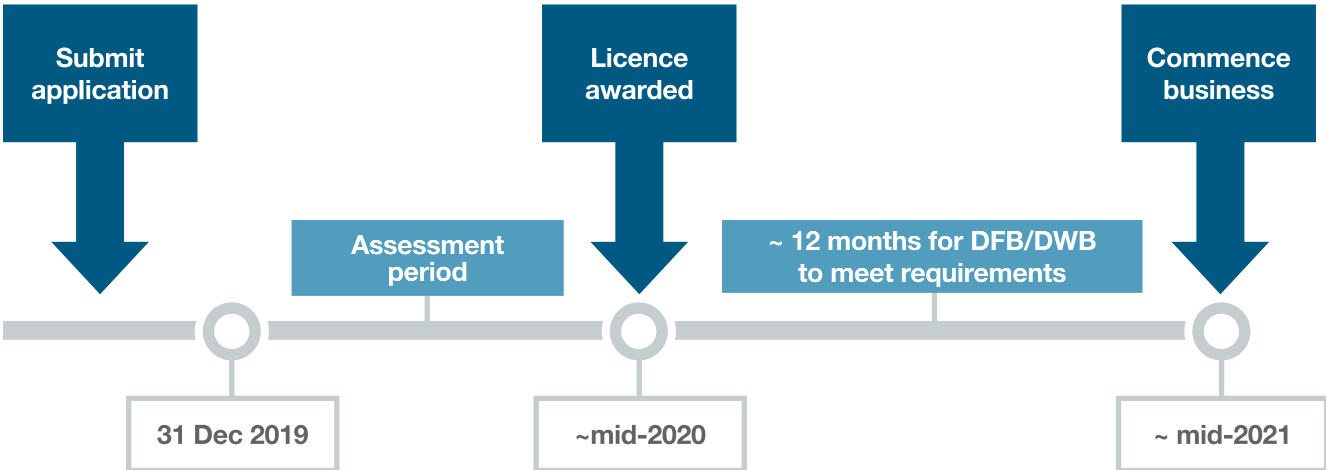
With the heavy emphasis on technology, we expect additional scrutiny on the DFB and DWB applicants' ability to comply with the technology risk management measures, with particular emphasis on cyber hygiene, system resiliency and cybersecurity controls.

The only relaxation on the compliance front is the phased-in approach for DFBs for board compositions where DFBs will be allowed to have a minimum of five directors, with one third of the board being independent directors, during the first five years of operations. This will increase to a minimum of seven directors with a majority of the board being independent directors, after the first five-year period.

1 The requirement is for 6.5% CET1 Capital Adequacy Ratio (CAR), 10% Total CAR, 2.5% capital conservation buffer, and up to 2.5% countercyclical capital buffer.

Timeline

An indicative timeline for the application and establishment of a DFB or DWB is as follows:



Prospective applicants must submit their applications by 31 December 2019. The MAS is expecting to announce the licence awardees in the middle of 2020[2], with commencement of business anticipated to be in the middle of 2021.

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2 For the successful applicant, once the MAS gives its in-principle approval, it will have 12 months to comply with the conditions under the in-principle approval, including meeting the applicable minimum paid-up capital. After all the conditions have been met, the digital bank will be awarded the licence and can commence business.

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