

A hand holding a smartphone displaying a menu in French. The menu items are: 1: SEEN Sawki, 2: SEEN Prepaye, ---, 9: menu, 0: retour. The phone's status bar shows 44% battery and 17:48. The background features a mechanical scale with a circular dial.

DIGITAL BANKS

How can they be regulated to deepen financial inclusion?

ACKNOWLEDGMENTS

The authors would like to thank Harish Natarajan (World Bank), as well as CGAP colleagues Ivo Jenik and Joep Roest for reviewing and providing invaluable feedback on this study.

CONSULTATIVE GROUP TO ASSIST THE POOR

1818 H Street NW, MSN F3K-306

Washington DC 20433

Internet: www.cgap.org

Email: cgap@worldbank.org

Telephone: +1 202 473 9594

© CGAP/World Bank, 2021.

Cover slide photo credit: Nicolas Réminé via Communication for Development Ltd.

RIGHTS AND PERMISSIONS

This work is available under the Creative Commons Attribution 4.0 International Public License (<https://creativecommons.org/licenses/by/4.0/>). Under the Creative Commons Attribution license, you are free to copy, distribute, transmit, and adapt this work, including for commercial purposes, under the following conditions:

Attribution—Cite the work as follows: Kerse, Mehmet, and Stefan Staschen. 2021. “Digital Banks: How can they be regulated to deepen financial inclusion?” Slide Deck. Washington, D.C.: CGAP.


Translations—If you create a translation of this work, add the following disclaimer along with the attribution: This translation was not created by CGAP/World Bank and should not be considered an official translation. CGAP/ World Bank shall not be liable for any content or error in this translation.

Adaptations—If you create an adaptation of this work, please add the following disclaimer along with the attribution: This is an adaptation of an original work by CGAP/World Bank. Views and opinions expressed in the adaptation are the sole responsibility of the author or authors of the adaptation and are not endorsed by CGAP/World Bank.

All queries on rights and licenses should be addressed to: CGAP Publications, 1818 H Street, NW, MSN F3K-306, Washington, DC 20433 USA; e-mail: cgap@worldbank.org.

TABLE OF CONTENTS

DIGITAL BANKS: HOW CAN THEY BE REGULATED TO DEEPEN FINANCIAL INCLUSION?

 Executive Summary.....	4	 III. Phased Authorization of Digital Banks.....	38
 I. Regulating Digital Banks.....	6	 IV. No Separate Digital Bank Licensing Regime.....	51
 II. Bespoke Digital Bank Licensing Regime.....	20	 V. Recommendations for Regulators.....	56

EXECUTIVE SUMMARY

A new wave of digital banks that adopt new technologies to offer banking products and services is emerging globally.

With their innovative application of technology, advanced analytical capabilities, and lower operational costs, **digital banks have a potential to offer more affordable services to underserved customers**, which would align with the needs and wants of this segment.

In this deck, “**digital bank**” is defined as a financial services provider with a banking license that adopts new technologies in all its operations (back office and front office delivery) to offer banking products and services through mainly digital channels.

We identified the following three regulatory approaches to digital banks globally that could accommodate new business models with the potential of a positive impact on financial inclusion.

- i. A few countries have created a **special licensing category for digital banks** in addition to their existing traditional banking category.
- ii. A few countries preferred to follow a **phased authorization approach for digital banks (or for all banks)**, where new players should or can go through a restricted phase before becoming a fully licensed bank.
- iii. However, the majority of jurisdictions **have not created a separate license category for digital banks** and do not offer them to go through a phased approach of licensing.

EXECUTIVE SUMMARY

The **creation of a new licensing category may not be necessary**. Where traditional banks and digital banks are allowed to offer a similar range of products and services, they pose similar risks and are best regulated the same way. Otherwise, in practice, the bespoke licensing regime is difficult to implement without creating uneven playing field issues and opportunities for regulatory arbitrage.

The adoption of innovative use of technology and data could enable digital banks to **understand the needs of the low-income clients** and to offer them **appropriate financial services at a lower cost** than incumbents. However, the innovative application of technology should not be limited to digital banks and is not a sufficient reason for the creation of a new licensing category. The regulatory approach towards digital banks should consider that traditional banks are also digitizing their operations and that the distinction between both types of banks will rapidly fade away over time.

The **promotion of financial inclusion is an explicit objective** in most of the countries having introduced a bespoke digital bank licensing regime. However, this objective risks being undermined by **restrictions on the use of physical touch points**. This restriction may directly stifle innovation around physical distribution in general and pose a major obstacle in particular for providers serving low-income clients in rural areas. CGAP has identified no clear rationale for such restrictions that appears to outweigh these concerns.

The phased authorization approach could be of interest to and useful for fintechs, which may need the restricted phase to attract the required level of investment, build IT systems and infrastructure, recruit staff, bring on the expertise necessary, and engage with third-parties.

A phased authorization approach that applies to any FSPs including traditional banks, digital banks, and other licensed entities could have a potential to **encourage the entry of inclusive players to the financial sector**. The policy makers should delve into the potential impact of such an approach on financial inclusion.

I. REGULATING DIGITAL BANKS



REGULATING DIGITAL BANKS

Overview

Technological innovation has been changing the banking landscape around the world. However, in many markets the banking sector is highly concentrated with a small number of banks holding a large share of the market. For example, some of the countries discussed in this research are highly concentrated with the share of the [five largest banks](#) in terms of asset size being 94% in Australia, 83% in Brazil, 84% in Germany and Korea, 94% in Singapore, and 98% in South Africa.

Limited competition and the oligopolistic structure of the banking sector in many markets make **incumbents slow to innovate**. This risks customers missing out on lower prices and greater choice and dealing with poor customer service not meeting their needs.

Regulators around the globe recognize **the need to increase competition in their market and prompt its modernization**, which would bring better outcomes for customers.

This is why some regulators wanted to lure **new players with novel, distinct and potentially disruptive business models** that can leverage the new technologies to offer better and cheaper banking services.

The expectation is that **the entry of an increased number of digital banks may bring more competition and push the incumbents to respond** by improving their offerings with lower prices, greater choice and quality of service that better meet the needs of customers including the underserved.

CGAP has been studying emerging business models of digital banks for some time. [Jenik and Zetterli](#) (2020) identified and described **three distinct models** that are particularly promising in advancing financial inclusion:

- Fully digital retail bank
- Marketplace bank
- Banking-as-a-service (BaaS)

REGULATING DIGITAL BANKS

Overview

Digital bank regulation follows one of the following three approaches:

- They could be covered under a **bespoke digital bank licensing regime** often with an explicit financial inclusion objective
- They could benefit from **phased authorization of banks**
- Or they could be treated as any other bank in countries where there is no **separate digital bank licensing regime**

The first and second approach could be combined with only digital banks covered under the bespoke licensing regime benefitting from a phased authorization.

At this stage, we do not have enough evidence to decide whether either of these approaches yields particularly satisfactory results in improving financial inclusion.

Existing bank regulation may or may not pose a potential bottleneck for inclusive players and thus for harnessing the potential of digital banks for financial inclusion.

What is clear, however, is that the most successful digital banks cannot be necessarily found in those countries with a bespoke digital bank licensing regime – some countries have digital bank licenses, others have digital banks ([Kerse and Jenik 2020](#)).

This deck primarily targets policy makers in emerging markets and developing economies (EMDE), who are interested in making the best use of the potential of digital banks to bring welcome competition and innovation to the banking sector and advance financial inclusion and want to learn about other countries' experience in doing so.

It describes details of the **three identified regulatory approaches** with the objective of helping policy makers make better informed choices for what could be the preferred approach for their country.

REGULATING DIGITAL BANKS

Overview

The focus in this deck is on the broad approaches in regulating digital banks without looking at specific regulatory enablers for digital banks such as agent-based distribution models, risk-based CDD, digital onboarding, and consumer protection, which are required for all digital banks regardless of the broad regulatory approach chosen (see [Basic Regulatory Enablers for Digital Financial Services](#) (Staschen and Meagher 2018)).

The deck does not include a comprehensive discussion on the risks of digital bank business models and what supervisors should do to address such risks.¹

CGAP has been studying emerging business models of digital banks

CGAP has also published case studies of fully digital retail banks from **India**, **the Philippines**, and **South Africa**. See [Inclusive Digital Banking: Emerging Markets Case Studies](#) (Jenik, Flaming, and Salman 2020).

¹ see Digital Banks: The Experience so Far, Opportunities and Challenges (World Bank forthcoming)

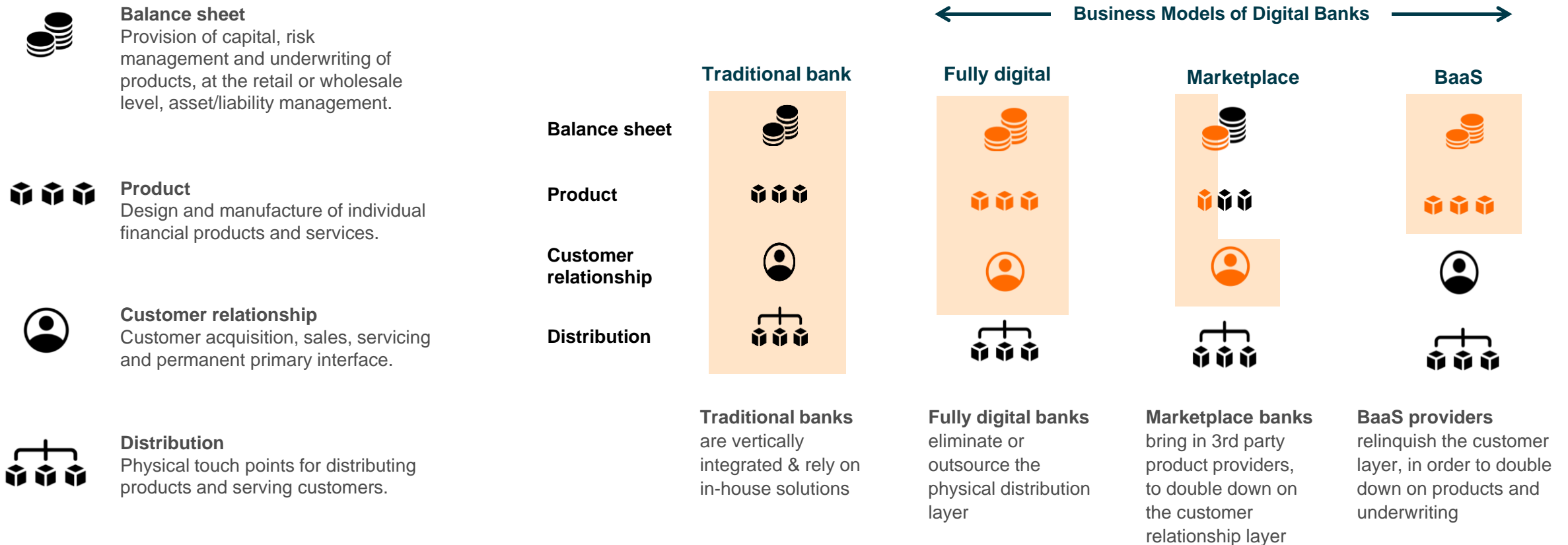
CGAP continues this work of collecting evidence about the **impact** of specific digital banks on customers' access to financial services by adding case studies of BaaS and marketplace banks.



To learn more about business models of digital banks and to stay updated, follow CGAP's relevant collection page at cgap.org/fintech or click on QR code.

REGULATING DIGITAL BANKS

Emerging business models represent different choices for strategic focus across four functional layers







Source: [Jenik and Zetterli \(2020\)](#)

REGULATING DIGITAL BANKS

Impact on inclusion: cost, access, fit, and experience

CGAP hypothesizes that these business models may expand financial inclusion in general in four key dimensions (see the table below) and has collected some early evidence on the financial inclusion impact of fully digital retail banks. [Jenik and Zetterli \(2020\)](#) also show how each model creates potential advantages in the respective dimensions.

 Cost	 Access	 Fit	 Experience
<p>Does the business model make financial products or services more affordable for providers to offer and for underserved customers to use?</p> <ul style="list-style-type: none">• Lowers end user fees• Offers more flexible payments• Reduces the need for expensive devices• Requires less or cheaper connectivity• Reduces the need for collateral	<p>Does the business model make financial products or services more accessible to underserved customers?</p> <ul style="list-style-type: none">• Expands range of products on offer to underserved segments• Expands eligibility through innovative CDD• Expands eligibility through innovative risk assessment• Requires less interaction at physical transaction points• Expands or improves the distribution of physical transaction points	<p>Does the business model make financial products better suited to the needs and wants of underserved customers?</p> <ul style="list-style-type: none">• Addresses a customer need not served by typical products• Aligns better with the needs and wants of underserved customers• Allows greater customization to different situations, user needs and preferences• Is better suited for target customers• Has higher general trust and satisfaction from users	<p>Does the business model make financial products easier for underserved customers to use and understand?</p> <ul style="list-style-type: none">• Has product features that are easier to access, understand, and compare• Has an interface that most customers find easy to understand and use• Delivers clear value to users• Helps users identify, understand and resolve problems• Gives users control over data• Provides stronger technical security

REGULATING DIGITAL BANKS

Digital banks have potential in advancing financial inclusion

TymeBank | SOUTH AFRICA

- Central to TymeBank's value proposition is the ability to offer customers **better pricing than the competition**. The overall cost to customers is around half of the cheapest incumbent in the market. TymeBank offers attractive deposit rates in accounts that are tailored to suit lower income customers.
- TymeBank plans to create a new loan product by leveraging its rich data and algorithmic decisioning platform to offer loans at risk-based pricing that is significantly lower than that of incumbents, which are charging interest rates close to the upper limits established by South African regulators.
- **85% of new clients are on-boarded through the bank's kiosks** located at retail stores. Customers can use these kiosks to sign up for an account and receive a personalized debit card in less than 5 minutes.

Source: [Jenik, Flaming, and Salman \(2020\)](#)

811 | Kotak Mahindra Bank | INDIA

- Kotak Mahindra Bank (KMB) launched Kotak 811 in March 2017 to attract mass-market retail customers. 811 is the digital arm of KMB and is not a separate legal entity.
- In 18 months since the launch, KMB's customer base doubled from 8 million to 16 million.
- 811 is **helping customers overcome some critical barriers to formal finance**, including affordability and the physical barriers associated with branch-based banking. The numbers indicate that 811 is advancing financial inclusion.
- Data shared with CGAP from 811 suggest that a significant proportion of all customers are **first-time account holders**, and a large proportion have low incomes—income lower than the minimum taxable income in India of INR 250,000 (US\$3,400).
- 811 customers are increasingly **graduating from basic accounts to using a variety of financial products**.

Source: [Jenik, Flaming, and Salman \(2020\)](#)

REGULATING DIGITAL BANKS

Digital banks have potential in advancing financial inclusion

UnionBank | THE PHILIPPINES

- Union Bank represents an ambitious attempt by a traditional bank to improve its core business and grow a mass-market business through digital transformation. The digitization is helping to onboard customers faster and remotely, improve their experience through a mobile app, and drive a customer-centric approach through data analytics.
- Digital onboarding is especially relevant to dispersed low-income populations. It takes less than 5 minutes, while the onboarding at a bank branch takes around 15 minutes.
- The bank is willing to invest significantly in technology to add a mass-market business line to its legacy corporate business. The multiplan strategy includes elements that have potential **to reach millions of mass-market customers and the underserved MSME segment with new channels, partnerships, and products.**

Source: [Jenik, Flaming, and Salman \(2020\)](#)

kakaobank | KOREA

- Kakao Bank is a digital bank established in 2017 that offers different types of accounts and is mostly focused on the retail market. Opening an account can be completed in 7 minutes and can be achieved through the app or Kakao's website.
- **The bank exempts its customers from fees for transactional services**, including cash-outs at ATMs and transfers to other banks. It also lowered foreign wire transfer and remittance fees to 10% of incumbent banks for select countries.
- Although Korea is a country with deep financial access to savings and payments, **digital banks have contributed to the expansion of credit to the underserved** – typically self-employed individuals or young people.
- K-bank, another digital bank in Korea, was licensed in 2016. Since the entry of Kakaobank and K-bank, **Korea's banking sector, especially incumbent traditional banks, have been:**
 - Lowering fees and making deposit/lending rates more competitive,
 - Speeding up the digitalization of their banking services,
 - Making their mobile applications more convenient and user-friendly.

Source: [World Bank \(2020\)](#) and World Bank (forthcoming).

REGULATING DIGITAL BANKS

Neobank, challenger banks, digital banks – but not all of them have a banking license

- **Neobanks, challenger banks, and digital banks** are some of the terms used to refer to FSPs offering services through digital channels. However, not all of these providers have a **banking license**.
- Getting a bank license often requires onerous capital and technical requirements. It could be **difficult and costly for nonbank fintechs**. For example, in the United States, it took [Varo Money three years and around US\\$100 million to get a national bank license](#).
- Many fintech companies increasingly offer products and services **without a banking license**. Sometimes they have an **e-money issuing license** or **other financial license**; sometimes they partner with a licensed bank to provide financial services (e.g., BaaS model), instead of applying for their own license. Another option is that they buy an existing bank to acquire a license.
- Many of these “nonbank banks” look a lot like banks, and consumers typically **cannot easily tell the difference**.



REGULATING DIGITAL BANKS

Some providers without a banking license refer to themselves as a bank

- Some providers, including fintechs, with no banking licenses call themselves “banks” or give the impression in their marketing materials and websites that they are banks and offer banking products and services.
- **Nubank** in Brazil, for example, doesn’t have a banking license. However, it uses the word “bank” even in its name.
- Often, **regulators are not happy with this** situation and order such providers to stop using the word “bank”. For instance, California’s Commissioner of Financial Protection and Innovation recently [warned the fintech company Chime](#) not to refer to itself as a bank.



chime®
**Banking that has
your back**

- The [UK’s FCA recently warned EMI](#)s against comparing themselves to **banks**. FCA stated that they were concerned that many e-money firms compare their services to traditional bank accounts or hold themselves out as an alternative in their financial promotions, but do not adequately disclose the differences in protections between e-money accounts and bank accounts.

REGULATING DIGITAL BANKS

How do we define “digital bank” in this deck?

In this deck, we define “**digital bank**” as a financial services provider (FSP) with a banking license that adopts new technologies in all its operations (back office and front office delivery) to offer banking products and services through mainly digital channels.

A digital bank **may** or **may not** have some level of **physical presence** (e.g., branches, agents, kiosks) depending on its business model and the regulations of the country.

Fintechs and other providers **without a banking license** that provide specific types of services such as payments or lending **fall outside the scope** of our definition and hence are not covered in this work.

“**Traditional bank**” refers to an entity that is allowed to conduct the broadest range of activities, including taking deposits from the public and providing credit. Traditional banks often heavily **rely on their legacy systems and physical delivery channels**. They are referred to in country regulations under various names, such as commercial banks, universal banks, deposit money banks, and others.



Main Research Question

What are the main existing **regulatory approaches to digital banks** that could accommodate new business models with the **potential of a positive impact on financial inclusion**?



Research Methodology

During our work, we conducted extensive **desk research** of regulations of the focus countries, annual reports, press releases, news articles, and other public resources. We also **held interviews** with several regulators from different countries around the globe.

REGULATING DIGITAL BANKS

Global approaches to licensing of digital banks

This deck focuses on the **three main approaches** to licensing of digital banks:

1

Bespoke Digital Bank Licensing Regime

A few countries have created a special licensing category for digital banks in addition to their existing category for traditional banks.

2

Phased Authorization of Digital Banks

A few countries preferred to follow a phased approach to licensing. In this approach, new players should or can go through a restricted phase, where they are not subject to the full set of regulatory requirements but can only conduct a limited range of activities and might be subject to other limitations, before becoming a fully licensed bank. This option can either be limited to digital banks or offered to all banks regardless of whether they are digital or not.

3

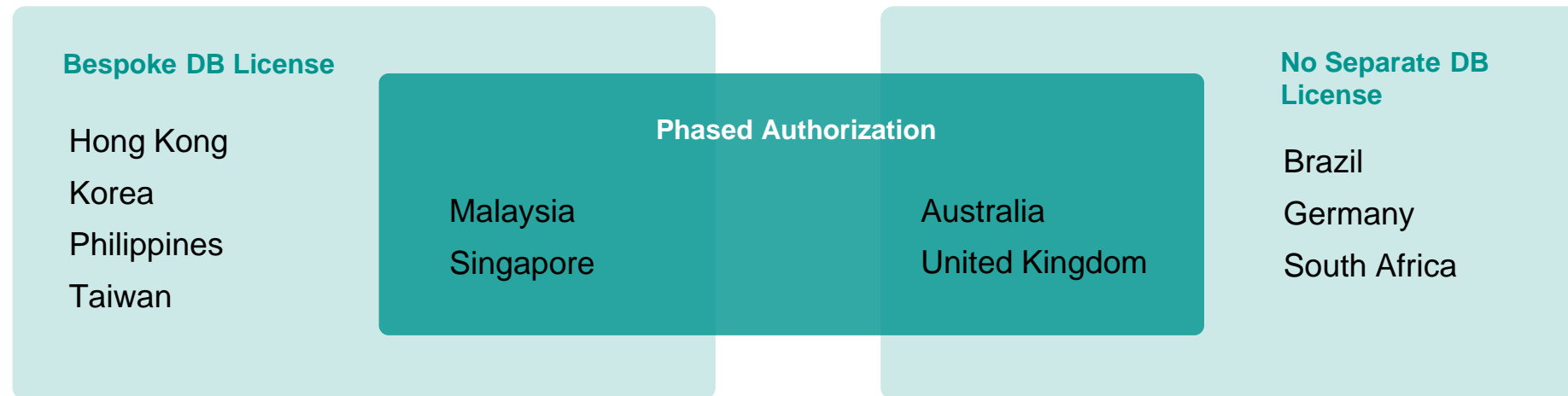
No Separate Digital Bank Licensing Regime

The majority of jurisdictions have not created a separate license category for digital banks and/or do not offer them to benefit from a phased authorization approach. In other words, this is the “do nothing” approach. It means that digital banks are treated as any other bank under their existing legal framework for banks.

REGULATING DIGITAL BANKS

Global approaches to licensing of digital banks

- We give some examples of countries below that fall under each approach.
- Brazil, Germany, and South Africa are examples for countries that do not have a separate digital bank licensing regime but have **digital banks with a substantial numbers of customers**.
- There are **only a few countries** that adopted a bespoke licensing regime. Malaysia as one of them hasn't issued any licenses as of November 15, 2021.
- The **phased authorization** is either limited to digital banks or open to all banks.



The list is **not exhaustive**. Most countries didn't create any licensing categories for digital banks. Only a few of them are shown in the chart. Most of the examples here are from developed or emerging markets that have higher financial inclusion levels than developing economies. The reason is that this is where digital banks or digital bank licenses can mostly be found to date. The topic of digital bank regulation is highly of interest to policy makers and regulators across markets and continues to be a point of discussion.

REGULATING DIGITAL BANKS

Licenses issued to digital banks in the focus countries

Approach		Country	Launch Date	Digital Bank licenses
Bespoke DB Licenses		Hong Kong	2018	8 ‘virtual bank’ licenses issued: Airstar Bank, Ant Bank, Fusion Bank, Livi Bank, Mox Bank, Ping An Oneconnect Bank, WeLab Bank, and Za Bank
		Korea	2019	3 ‘internet-only bank’ licenses issued: Kakao Bank, K-Bank, and Toss Bank
		Philippines	2020	6 ‘digital bank’ licenses issued so far: Overseas Filipino Bank, Tonik, UNOBank, Union Digital Bank, Gotyme, and Maya Bank
		Taiwan	2018	3 ‘internet-only bank’ licenses issued: Line Bank, Next Bank, Rakuten Bank
Bespoke DB Licenses	Phased Authorization (for only digital banks)	Malaysia	2020	The plan is to issue up to 5 ‘digital bank’ licenses
		Singapore	2019	2 Digital Full Bank and 2 Digital Wholesale Bank licenses issued
No Separate DB Licenses	Phased Authorization (for all banks)	Australia	2018	4 ADI licenses issued to digital banks: Judo Bank, 86400 Ltd., Volt Bank, and Xinja <i>Bank</i> . <i>Two of them preferred to follow ‘restricted route’</i> . <i>IN1Bank</i> , Alex Bank, and Avenue Bank now have a "restricted ADI" license
		UK	2013	26 bank licenses issued since 2013, with some of them following the mobilization route and some of them also being digital banks: e.g., Monzo, Starling Bank, Zopa
No Separate DB Licenses		Brazil		E.g., Banco Inter, Banco Digio, Banco Original, B3
		Germany		E.g., DKB, ING Bank, N26, Norisbank and Comdirect (both subsidiaries of traditional banks)
		South Africa		E.g., Discovery Bank, TymeBank

This table shows the state in respective countries as of November 15, 2021

II. BESPOKE DIGITAL BANK LICENSING REGIME



II. BESPOKE DIGITAL BANK LICENSING REGIME

Only a few countries around the globe created a bespoke licensing regime for digital banks. In this slide deck, we feature six of them: **Hong Kong, Korea, Malaysia, the Philippines, Singapore, and Taiwan.**

A few other countries are considering adopting the bespoke licensing approach for the future. Pakistan is the only one covered here, as it already issued a draft regulation (even though this is likely to change before being adopted).

Regarding our focus countries, **we primarily intend to understand the below aspects:**

- How do the regulations **define a “digital bank”** in the respective countries?
- What are the **primary objectives** of these countries in creating a special licensing tier for digital banks? Why did policy makers think this category is needed in addition to the existing traditional bank category?
- Are digital banks required to **serve specific segments** in the country?
- What **delivery channels** can digital banks use to offer products and services? Are they allowed to use physical channels? If yes, to what extent?

- What are the main **differences between digital banks and traditional banks** with regards to regulatory requirements?
- Are the **shareholding requirements** for digital banks different from those for traditional banks? If so, how? Why?
- Is the **scope of permitted activities** for digital banks different from those for traditional banks?

II. BESPOKE DIGITAL BANK LICENSING REGIME

How is “digital bank” defined in the focus counties?

Different terms are used by different regulators to refer to these banks such as **digital bank**, **virtual bank**, and **internet-only bank**. The countries have different definitions for such banks, although they essentially mean the same. We use the term “**digital bank**” to refer to all of them.



HONG KONG

A **virtual bank** is defined as a bank which primarily delivers retail banking services through the internet or other forms of electronic channels instead of physical branches.



PHILIPPINES

A **digital bank** offers financial products and services that are processed end-to-end through a digital platform and/or electronic channels with no physical branch/sub-branch or branch-lite unit offering financial products and services.



KOREA

An **internet-only bank** is defined as a bank that conducts banking business mainly through electronic financial transactions “as prescribed in (...) the [Electronic Financial Transactions Act](#).”



SINGAPORE

Not separately defined



MALAYSIA

A **licensed digital bank** is defined as a person licensed to carry on banking business wholly or almost wholly through digital or electronic means.



TAIWAN

An **internet-only bank** is a bank that mainly utilizes the internet or other forms of electronic communication channels to provide financial services to its customers.

II. BESPOKE DIGITAL BANK LICENSING REGIME

Implications of the “digital bank” definition

As seen in the previous slide, a digital bank is typically defined as a bank that primarily uses digital channels to provide products and services to customers. Considering these definitions, some questions arise:

Implementing digital solutions and digitization of operations, and the innovative application of technology is a general trend among banks around the globe. Traditional banks are also quickly shifting towards digital in many countries. In this case, **is making this distinction between banks as digital or not useful?** Is it still necessary, and even if it is now, for how much longer?

There could be cases where a traditional bank decides **to close all its branches and to rely on digital channels**. In this case, would it fall under the definition of “digital bank”? And more importantly, would this bank need to apply to the regulator to switch its license to that of a digital bank? Similarly, what if a digital bank intends to open branches at some point? Would it need to switch its “digital bank license” to the license for traditional banks?

II. BESPOKE DIGITAL BANK LICENSING REGIME

Stated policy objectives and target customers in digital bank regulation



HONG KONG

- Promote the application of **financial technology** and **innovation** in Hong Kong and offer a new kind of **customer experience**.
- Promote **financial inclusion** as digital banks normally target the **retail segment**, including the **SMEs**.



MALAYSIA

- Add **dynamism** to the banking landscape to serve the economy and contribute to individual well-being.
- Expand meaningful **access** to and **responsible usage** of suitable financial solutions for **underserved/unserved** market segments, which include **retail, micro enterprises, and SMEs**.



TAIWAN

- Drive market **innovation** and development.
- **Push the incumbents** to speed up the digitization of their operations and to offer more affordable and user-friendly services through new business models and technologies.
- Enhance **financial inclusion**.



KOREA

- Promote **financial innovation** and **sound competition** in the banking business.
- Promote the **convenience** for financial consumers.



PHILIPPINES

- Expand services into the **unserved** and **underserved** market segments.
- Allow **responsible innovation** to flourish.
- Promote **cyber resilience**.
- Advance the **digitalization** of the financial industry.



PAKISTAN (DRAFT)

- Promote **financial inclusion**.
- Provide credit access to **unserved** and **underserved**.
- Extend **low cost DFS**.
- Encourage application of **financial technology** and **innovation** to banking.
- Foster new set of **customer experience**.
- Further develop **digital ecosystem**.



SINGAPORE

- A Digital Full Bank should incorporate the **innovative use of technology** to serve customers' needs and reach **under-served** segments of the Singapore market, that differentiates it from existing banks.

Sources: Respective country regulations (See [References](#))

II. BESPOKE DIGITAL BANK LICENSING REGIME

Common stated objectives across these countries

- These regulators, in general, recognize that digital banks can bring **more competition** to a highly concentrated banking sector and prompt its modernization.
- Promoting **innovation** and **financial inclusion** are common objectives across these regimes.

While it is great to see that “**financial inclusion**” is explicitly mentioned as an objective, there are a few issues worth raising when it comes to implementation:

- In some cases, it is not clear **what exactly the regulations mean by financial inclusion**, as it is not defined in more detail.
- It is also not clear how the regulator is going to **enforce the alignment with the “financial inclusion” objective** both at the point of licensing, but also throughout the life of digital banks.
- To turn this into a meaningful objective, regulators may need to **define indicators** that help them understand to what extent these digital banks serve the excluded and underserved segment and whether they contribute to advancing financial inclusion.

- From among the countries with bespoke licensing regimes discussed above, only Malaysia requires during the licensing process that the applicant’s business plan also includes performance indicators that demonstrate the proposed digital bank’s progress in fulfilling the financial needs of the unserved and/or underserved segments.
- A broader question is **whether it is useful to link financial inclusion and digital banks** in the way it is done in some of these countries. Promoting financial inclusion and serving the excluded and underserved can be done through any existing FSP license and digitization could be a strategy for a bank regardless of whether it has a financial inclusion focus or not.

II. BESPOKE DIGITAL BANK LICENSING REGIME

Distribution and physical touch points



HONG KONG

- Required to have a principal place of business in Hong Kong.
- **Not expected to maintain physical branches but** could maintain one or more local offices for promotion.



PHILIPPINES

- Required to maintain a principal/head office in the Philippines.
- **Not allowed to have physical branch/sub-branch or branch-lite units.**
- Allowed to offer products and services through agents and other qualified service providers.



SINGAPORE

- Allowed to **only open one physical place of business.**
- Not allowed to operate ATMs or cash deposit machines (CDM) or join existing ATM or CDM networks.
- Allowed to offer cashback services through electronic funds transfer at point of sale (EFTPOS) terminals at retail merchants so that the DFB can meet retail customers' urgent cash needs.



TAIWAN

- **Not allowed to establish branches,** except for the head office and the customer service center as the only physical presence.



KOREA

Not specified



MALAYSIA

- Required to establish an office in Malaysia.
- **Not allowed to establish a branch.**
- Agents can be used – subject to BNM approval.
- Allowed to establish physical offices for administrative purposes.
- Allowed to use registered office and physical offices as a center to facilitate face-to-face customer complaints.
- Allowed to participate in Shared ATM Network and cash-out services.
- Allowed to use network of self-service terminals, incl. ATMs, cash deposit machines, and cheque deposit machines of other banks.

- All these countries have **some restrictions on the physical presence of digital banks.** And most of them do not allow for opening a branch. However, these restrictions may stifle innovation around physical distribution and **pose a major obstacle for providers serving low-income customers in rural areas,** who still need physical channels for basic transactions and where branches can play an important role in cash distribution.

- A [CGAP study](#) showed that except in a few countries (e.g., Sweden, Norway, and China), where physical money is increasingly a thing of the past, most DFS users around the world require a trusted, affordable, and easy way to convert their cash to digital money and vice versa. The impact of DFS on financial inclusion depends not only on providing more attractive DFS use cases to people but also on building out broader, more convenient cash-in/cash-out (CICO) networks that enable more people to start using DFS.

II. BESPOKE DIGITAL BANK LICENSING REGIME

Difference in scope of permitted activities and capital requirements of digital banks and traditional banks

Three examples: the Philippines, Korea, and Pakistan



PHILIPPINES

- Digital banks are allowed to offer a **more limited range of products and services** compared to the category of traditional bank (referred to as commercial bank) in the Philippines. While commercial banks, for example, can issue letters of credit; purchase, hold and convey real estate and invest in the equity of enterprises under certain limits; and buy and sell gold or silver bullion, these are not listed in the scope of activities of digital banks.
- Also, while a digital bank must have a minimum capital requirement (MCR) of P1 billion (US\$21 million), this requirement is P2 billion (US\$42 million) for a commercial bank plus additional capital for its branches.
- The difference between digital banks and traditional banks in terms of MCR could be due to difference in scope of permitted activities for these two categories.

II. BESPOKE DIGITAL BANK LICENSING REGIME

Difference in scope of permitted activities and capital requirements of digital banks and traditional banks



KOREA

- Digital banks in Korea are **not allowed to offer loans to larger corporates**. However, they can provide loans to **individuals and SMEs**, which could help enhance financial inclusion. This restriction does not apply to traditional banks.
- As shown in the table, a traditional bank must maintain an **MCR of KRW100 billion** (US\$90 million), as compared to only KRW25 billion (US\$22 million) for a digital bank. This difference could be due to differences in scope of permitted activities and **limitations in businesses** between these two types of banks, among others.

	Banking Act	Special Act on Internet-only banks
Minimum Capital	KRW 100 billion	KRW 25 billion
Non-financial shareholding	4% of voting shares (max 10% allowed with voting shares limited to 4%)	34% of voting shares
Lending to major shareholder	Up to 25% of equity	Prohibited
Acquisition of securities issued by major shareholder	Up to 1% of equity	Prohibited
Limit on lending to single borrower	Same individual or corporation: up to 20% of equity	Same individual or corporation: up to 15% of equity
Limit on lending to same borrower (borrower and related parties as a whole)	up to 25% of equity	up to 20% of equity
Scope of credit	Individuals and corporates	Individuals and SMEs

Source: [World Bank \(2020\)](#)

II. BESPOKE DIGITAL BANK LICENSING REGIME

Difference in scope of permitted activities and capital requirements of digital banks and traditional banks



PAKISTAN (draft)

- State Bank of Pakistan recently issued a [draft digital bank regulatory framework](#). The draft defines two types of digital banks: Digital Retail Bank (DRB) and Digital Full Bank (DFB).
- A DRB is only allowed to deal with retail customer segments, while they cannot offer services to the corporate or commercial segment except digital cash management services within certain limits.
- However, the above restriction does not apply to **DFBs, which can serve all corporate, commercial and retail segments in the same way as traditional banks.**
- As per this draft, a DRB must have an MCR of PKR4 billion (US\$26 million) after having gone through a transition phase. However, a DFB must maintain an MCR of PKR 10 billion (US\$65 million) after becoming fully licensed, which is the same as the MCR for traditional banks.
- This means that DFBs and traditional banks are subject to very similar prudential rules only that a DFB is not permitted to have any branches and needs to pursue a financial inclusion mandate.

- Unlike Korea, the Philippines and Pakistan (draft), digital banks and traditional banks have a similar range of permitted activities in **Hong Kong, Singapore, and Taiwan.**
- In these countries digital banks are also subject to similar regulatory requirements as traditional banks. For example, the MCR level for digital banks is the same as for traditional banks (Hong Kong: HKD300 million [US\$39 million], Singapore: S1.5 billion [US\$1.1 billion], and Taiwan: NT\$10 billion [US\$363 million]).

II. BESPOKE DIGITAL BANK LICENSING REGIME

Common stated objectives across these countries



KOREA

A non-financial company is allowed to own up to 34% of voting shares of a digital bank, while in the case of traditional banks it can only acquire up to 10% of total shares and not exercise voting rights for shares exceeding 4% of total shares.



SINGAPORE

At least one entity in the applicant group has three or more years of track record in operating an existing business in the technology or e-commerce field – something that is not required for traditional banks.



TAIWAN

Total shares of non-financial companies in a digital bank could be up to 60%, which is not allowed for traditional banks. There is a single shareholding limit for non-financial companies of 10% unless the promoter has a track record in operating business in the financial technology, e-commerce or telecommunication field.



HONG KONG

Both financial firms (including existing banks in Hong Kong) and non-financial firms (including technology companies) may apply to own and operate a virtual bank in Hong Kong.

The ability to have diverse shareholders on board may enable new digital banks to benefit from improved technological capabilities, using the shareholders' existing touch points, and better use of data through advanced analytics capabilities. All these may help a digital bank to offer more affordable products to underserved segments that would align with their needs.

II. BESPOKE DIGITAL BANK LICENSING REGIME

What has been the market response to these new licensing regimes?

In almost all of these countries with a bespoke licensing regime, regulators already issued multiple digital bank licenses with a focus on retail customer segments. These are a few examples focusing on the shareholder structure and (self-described) target segment of the newly licensed digital banks.

A digital entertainment and e-commerce company targeting the youth and SMEs



SINGAPORE

- One of the DFB licensees in Singapore is Sea Ltd. that will have 100% of total shares of the DFB.
- According to its website, the DFB will draw on insights about the needs of the users from across Sea's digital ecosystem to innovate processes, products, and services that will improve the lives of young consumers and SMEs in Singapore and support the growth of the country's digital economy by reducing the barriers to accessing financial services through technology.
- Sea Limited is a global consumer internet company founded in Singapore in 2009. It operates three core businesses across digital entertainment, e-commerce, as well as digital payments and financial services.

Source: [Sea Ltd.](#)

II. BESPOKE DIGITAL BANK LICENSING REGIME

A consortium of a ride-hailing/food delivery company and telecom company targeting time-starved professionals and microenterprises



- The Grab/Singtel consortium has recently been awarded a DFB license and is planning to launch the digital bank in early 2022. Grab Holdings Inc. (mainly focusing on **ride-hailing** and **food delivery**) has a 60% stake in the consortium while Singtel (**telecommunications company**) holds 40%.
- According to their website, the consortium will focus on **serving consumers and small and micro-enterprises, starting with time-starved young professionals, managers, executives and technicians, and gig workers with flexible incomes, who face limited access to financing**. Grab and Singtel plan to enable these underserved groups to easily access transparent financial services that are embedded in their everyday activities, helping them achieve a better quality of life.
- The consortium also stated that “With Singtel and Grab’s combined digital expertise and deep customer knowledge, we have the assets and the synergies to make banking more accessible and intuitive, to deliver much-needed product simplicity, speed and affordability to consumers and enterprises.”

Source: [Grab](#)

II. BESPOKE DIGITAL BANK LICENSING REGIME

A Chinese BigTech firm aiming to replicate its success in Hong Kong



- Ant Bank was granted a banking license in 2019. It is a wholly owned subsidiary of Ant Group Co. Ltd., a provider of financial services technology that specialized in blockchain, artificial intelligence, security, logistics, and cloud computing. The bank highlights that **it aims to use advanced fintech innovation to provide more secured, transparent, cost-effective and inclusive banking services to individuals and SMEs in Hong Kong.**
- According to its statement, Ant Bank also partners with AlipayHK to enable seamless integration of banking services into consumer's daily scenarios, such as clothing, food, rent, transportation and entertainment, to make them accessible to anyone at anytime and anywhere, offering much more convenient services. In addition, over 2 million current AlipayHK users will be able to open an Ant Bank account remotely through Ant Bank's Mini App in their existing e-wallet app, connecting banking services to almost every aspect of daily life.
- Ant Bank hopes to **promote financial inclusion in Hong Kong** through this partnership. In addition, Ant Bank will also make use of its capabilities in technology and innovation to **serve local SMEs**

Source: [Ant Bank](#)

II. BESPOKE DIGITAL BANK LICENSING REGIME

A consortium of FSPs offering full banking services using technology



- Line Bank was licensed as a digital bank in 2019. The consortium owning the bank is comprised of players **from different industries such as messaging, banking, and telecommunication**. The shareholders and their shares are as follows: Line Financial Taiwan (49.9%), Taipei Fubon Bank (25.1%), CTBC Bank (5%), FarEasTone (5%), Standard Chartered Bank (5%), Taiwan Mobile (5%), and Union Bank of Taiwan (5%).
- According to the website of Line Corporation, the digital bank will provide retail banking services including deposit, transfer, debit card and personal loans at the initial stage of business. They state that “our group affirms our plans to introduce banking services involving AI, big data and financial technologies, as well as our commitment to responsible innovation, as we develop innovative and secure personal finance experiences that **can truly improve banking for all consumers**. We will listen carefully to the voice of consumers, strive ceaselessly to be a trusted bank, and establish deep roots in Taiwan market, as we seek to **promote financial inclusion** for all through ubiquitous, internet-only banking services.” (highlights by CGAP)

Sources: [Line \(2019\)](#), [Line \(2021\)](#)

As seen in the digital bank profiles in this section, the dedicated licensing regimes are already helping diverse shareholders, such as **fintech and bigtech companies, and players from different sectors such as e-commerce and telecommunication industries** to move into the banking industry.

II. BESPOKE DIGITAL BANK LICENSING REGIME

Summary: Bespoke digital bank licensing regime



In general, to promote innovation and financial inclusion is an explicit objective in most of the countries having introduced a bespoke digital bank licensing regime. Increased competition in the banking industry is another objective in the majority of them.



A main difference between the regime of traditional banks and digital banks is the restrictions on the physical presence of digital banks. In most of these countries, digital banks are not allowed to open branches, in some not even to use any physical channels (i.e., no agents either).



In some (e.g., Hong Kong, Singapore, and Taiwan), the scope of permitted activities and the regulatory and supervisory requirements including MCR for digital banks is similar to those for traditional banks.



In some of these countries, another difference between the regime of traditional banks and digital banks is the shareholding requirements, which aims to have diverse shareholders in the banking industry, including non-financial companies with a track record in technology.

II. BESPOKE DIGITAL BANK LICENSING REGIME

Could this approach enable more players to enter the industry?

- Creating a separate licensing regime can be seen as a sign to the market that there is a **willingness and openness to issue new licenses**, to admit more players into the banking industry and an invitation of innovative business models to apply.
- Some countries following this approach has also adopted rules to **welcome more non-financial shareholders to the banking industry**. While new actors could help boost competition, diversity, and collaboration in banking, it may be more appropriate to amend existing regulation as needed, instead of creating a new licensing category. And many countries' existing regulations might not require any changes.

Do digital bank licenses facilitate financial inclusion?

- **Stated objectives to expand financial inclusion are undermined by restrictions on the use of physical touch points.** The restrictions on branches and in some cases also agents create a competitive disadvantage for digital banks relative to incumbents considering both types of banks are allowed to perform similar activities and subject to similar requirements in some jurisdictions. Worse, it may directly stifle innovation around physical distribution in general and pose a major obstacle in particular for providers serving low-income clients in rural areas. CGAP has identified no clear rationale for such restrictions that appears to outweigh these concerns.
- Also, a [recent CGAP study](#) shows that the expansion of DFS among a larger client base depends not only on providing more attractive DFS use cases to people but also on building out broader, more convenient CICO networks that enable more people to start using DFS.
- **Some of the most innovative providers serving low-income customers are not relying on a digital bank license.** Many in fact are in markets where no such category exists. See www.cgap.org/fintech for cases.

II. BESPOKE DIGITAL BANK LICENSING REGIME

Are new licensing categories needed?

- In some countries, the creation of a new licensing category doesn't **seem necessary**. Where traditional banks and digital banks are allowed to offer a similar range of products and services, they pose similar risks and are best regulated the same way. If they are not and are differentiated by scope of products and services, two parallel licensing regimes are difficult to implement without creating uneven playing field issues and opportunities for regulatory arbitrage.
- Also, the regulators would need to deal with a heavy burden of creating a new category, licensing digital banks separately, and trying to address issues that could lead to an uneven playing field. All of this would **impose additional costs on the regulators** who already have limited resources and capacity and potentially **keep them from addressing higher priority issues**.
- The adoption of innovative use of technology and data could enable digital banks to understand the needs of the low-income clients and to offer them appropriate financial services at a lower cost than incumbents.
- However, the **innovative application of technology should not be limited to digital banks** and not be the main reason for the creation of a new licensing category. Regulation should also consider that traditional banks are digitizing their operations at the same time and that the distinction between digital and traditional banks will rapidly fade away.
- In many markets, there are players with inclusive business models that intend to offer a limited range of activities but do not enter the industry since existing banking regulations are heavy. In this case, the new licensing category would not be useful for such applicants either since the **regulatory and supervisory requirements and the potential compliance costs would not be significantly different from those for traditional banks**.
- In some markets, the creation of this new category could **give the wrong impression to consumers intending to shift to digital channels that traditional banks do not offer services through these channels**, or that they are not good enough at it.



III. PHASED AUTHORIZATION OF DIGITAL BANKS

III. PHASED AUTHORIZATION OF DIGITAL BANKS

In the phased authorization approach, new banks must or can go through a restricted phase, where they are not subject to the full set of regulatory requirements and can only conduct a limited range of activities, before becoming a fully licensed bank. This approach can either only apply to digital banks or to all banks.

From among the countries with bespoke licensing regimes discussed above, **Malaysia** and **Singapore** require all digital bank applicants to go through a restricted phase before becoming a fully functioning digital bank.

In **the UK** and **Australia**, all banks can go through a restricted phase, regardless of whether they are traditional banks or digital banks. Going through the restricted phase is not a requirement, but is optional based on the choice of the applicant.

III. PHASED AUTHORIZATION OF (DIGITAL) BANKS



United Kingdom – Phased authorization

The UK has no separate licensing regime for digital banks. However, an applicant for a banking license can choose to go through a mobilization route (apply for an “Authorization with Restriction”) before becoming a fully licensed bank.

Benefits of the mobilization route: This route enables new banks to secure further investment, recruit staff, invest in IT systems, and commit to third party suppliers, etc. due to them being an authorized bank, but not yet subject to the full capital requirements. This period is generally more suitable for fintechs than for players promoted by shareholders with deep pockets to invest heavily in the startup phase.

Length of this period: Prudential Regulatory Authority (PRA) and Financial Conduct Authority (FCA) anticipate that new banks will want to progress quickly through the mobilization route. This could take as little as a few months but should take no longer than 12 months.

Deposit Limit: PRA and FCA limit the amount of total deposits that a new bank can accept to a total of £50,000 (US\$71,000) during the mobilization period.

MCR: Banks in the mobilization phase are subject to a capital requirement that tends to be lower than that set for a bank once it exits mobilization taking account of the fact that they are not yet fully operational. PRA and FCA communicate respective capital requirements to the bank during the application assessment process.

Customers: During the mobilization phase, the new bank needs to finalize its customer journey, including details of products, pricing, and onboarding arrangements.

A new bank in mobilization has time to fully develop **risk management and control structures, material outsourcing arrangements, IT infrastructure and systems, recovery plan, business continuity plan and policies and procedures** until it is fully licensed.

Sources: [Bank of England](#), [FCA](#)

III. PHASED AUTHORIZATION OF (DIGITAL) BANKS



United Kingdom – Mobilization route for new banks

The **mobilization route** has been widely used by banking applicants since it was introduced in 2013. **60% of firms** issued with a banking license **between 2013 and 2018** have first received a restricted authorization.

The FCA highlighted that this route made it easier for the banks to **attract the required level of investments** as they were able to raise capital in tranches in the mobilization phase.

Providers: Examples of digital banks that are going/went through the mobilization route:

- **Starling Bank:** The bank entered the mobilization route in [July 2016](#) and was fully licensed in [April 2017](#).
- **Monzo:** It was fully licensed in April 2017 after the mobilization period. (See more on Monzo [here](#)).
- **Vive:** The bank was [authorized with restriction](#) in 2020. The bank is planning to [target the underserved market of clients](#) who may not have access to credit at affordable costs.
- **Zopa:** The UK Peer-to-Peer lending company was [fully licensed in June 2020](#) after the mobilization route.

Source: [Bank of England](#)

III. PHASED AUTHORIZATION OF (DIGITAL) BANKS



Australia – Restricted route for ADIs

An applicant can go through the restricted route as a “restricted ADI” before becoming an Authorized Deposit-Taking Institution (ADI).

Objective of the regulator (APRA): To balance the objectives of enhancing competition and efficiency in the banking industry, while maintaining high levels of financial safety and financial system stability and a broadly competitive neutral regulatory framework.

Benefit of the restricted route: It allows a restricted ADI to conduct limited banking business while developing its capabilities and resources, demonstrating progress made towards fully complying with the prudential framework.

Length of this route: It could be for a maximum of 2 years.

Business limit: A restricted ADI should not grow significantly beyond a AUD100 million (US\$77 million) balance sheet.

Deposit limit: A restricted ADI can collect deposits from the public up to AUD2 million (US\$1.5 million). A deposit limit of AUD250,000 (US\$193,540) exists on the aggregate balance of all protected accounts held by an individual account-holder.

MCR: A Restricted ADI will at all times need a minimum capital of the higher of: AUD3 million (US\$2.3 million) plus a resolution reserve (typically set at AUD1 million [US\$774,158]); or 20% of adjusted assets. Fully licensed ADI must maintain, at all times, a prudential capital requirement and capital buffers as set by APRA in accordance with Prudential Standards APS 110 Capital Adequacy.

Customers: A restricted ADI can offer lower risk banking business products, including deposit products to a limited number of customers, which are expected to consist of staff of the Restricted ADI, their family and friends, and a small number of early adopters who have expressed an interest in being involved in the start-up phase of the Restricted ADI. Other members of the general public should not be able to apply for a new release product from a Restricted ADI.

Restricted ADI is subject to **typically lower MCR and stricter liquidity requirements** compared to a fully licensed ADI. Also, a restricted ADI has time to fully develop **material outsourcing arrangements, IT infrastructure systems** and **recovery plan until it is fully licensed**.

III. PHASED AUTHORIZATION OF (DIGITAL) BANKS



Australia – Restricted route for ADIs

Providers:

- Digital banks such as **Judo Bank** and **86 400 Ltd.** have been fully licensed without going through restricted phase.
- However, **Volt Bank**, **Xinja Bank**, and **In1Bank Ltd.** chose to benefit from this phase.
- In [January 2019](#), **Volt Bank** was fully licensed after a restricted phase.
- **In1Bank** was licensed as a [restricted ADI](#) in December 2019.
- APRA, the Australian regulator, recently approved the [acquisition of 86 400 Ltd.](#) by an incumbent, National Australia Bank.

Xinja Bank

- [In December 2019](#), Xinja Bank was fully licensed after a restricted phase.
- Xinja Bank was offering higher deposit rates than the market [while failing to offer lending products](#) that would earn sufficient revenue to sustain the operation. This led it to deplete its own capital.
- In December 2020, Xinja Bank announced that it intended to cease being a bank and [handed back its ADI license to APRA](#).
- APRA [revoked Xinja Bank's ADI license](#) in February 2021.

APRA has recently revised its approach to licensing ADIs

- In August 2021, APRA released [its revised approach to licensing and supervision of new ADIs](#).
- According to this, a restricted ADI must achieve a limited launch of at least one income-generating asset product (e.g., loans) and one deposit product before it can progress to an ADI license.

III. PHASED AUTHORIZATION OF DIGITAL BANKS



Singapore – Digital full bank and restricted phase

Any applicant for a DFB license must first go through a “restricted phase” which includes the 1) entry phase and then the 2) progression phase before it can become a fully functioning DFB.

Primary Objective of MAS to mandate a restricted phase: To minimize risks to retail depositors.

Length of the restricted period: MAS will **not pre-determine a time period** within which a restricted DFB must progress to a full functioning DFB. The pace of growth of a restricted DFB will depend on its ability to meet its commitments and MAS’ supervisory considerations. However, MAS generally **expects a DFB to be fully functioning within 3 to 5 years** from commencement of business.

Business Limitations throughout restricted phase:

- **Not allowed to safeguard other financial institutions' "relevant money"**, which is defined in Section 23/14 of the [Payment Services Act 2019](#) and includes the money received by a major payment institution from a customer in exchange for e-money.
- If a DFB offers **unsecured credit facilities** to an individual, it will only be allowed to grant a total unsecured credit limit of up to two times of the individual’s monthly income.
- Not allowed to conduct **any proprietary trading activities**.

Source: [Monetary Authority of Singapore](#)

III. PHASED AUTHORIZATION OF DIGITAL BANKS



Singapore – Digital full bank and restricted phase

Business Limitations - Entry phase only:

- A restricted DFB can operate overseas bank branches or subsidiaries in no more than two other markets.
- Where a restricted DFB offers investment products to individuals, it can only offer simple capital markets products.

MCR and Deposit Cap - Entry Phase:

- The restricted DFB can commence with an **MCR of S\$15 million (US\$11.3 million)** and will be subject to an aggregate **deposit cap of S\$50 million (US\$38 million)**.
- Deposits per individual will be capped at S\$75,000 (US\$56,634).
- MAS expects a restricted DFB to be in this phase for 1 to 2 years. In this phase, it **cannot solicit deposits from the general public**, but only from its shareholders, employees, related entities and any other persons who are familiar with the DFB's parent or major shareholders' businesses (e.g., existing customers of the parent entity).

MCR and Deposit cap - Progression Phase:

- After the entry phase, the aggregate deposit cap and the MCR of the restricted DFB will be progressively increased. MAS will not prescribe a path of growth for a restricted DFB. A DFB applicant should project its growth path based on its business plans, with the aim of meeting the **MCR of S\$1.5 billion (US\$1.1 billion)** within a reasonable period.
- MAS expects to see a path towards profitability in the financial projection. As a rule of thumb, in making its financial projection, a DFB applicant can assume that the **MCR** and the **aggregate deposit cap** will be increased **in tandem by a ratio of 1:4**.

After the entry phase

- A restricted DFB which has moved out of the entry phase will be able to solicit deposits from the general public.
- The deposit cap of S\$75,000 (US\$56,634) per individual will remain during the progression phase. The cap will be removed after the DFB becomes a fully licensed bank.

Source: [Monetary Authority of Singapore](#)

III. PHASED AUTHORIZATION OF DIGITAL BANKS



Malaysia – Digital banks and foundational phase

A digital bank must go through a “foundational phase” before becoming a fully licensed digital bank.

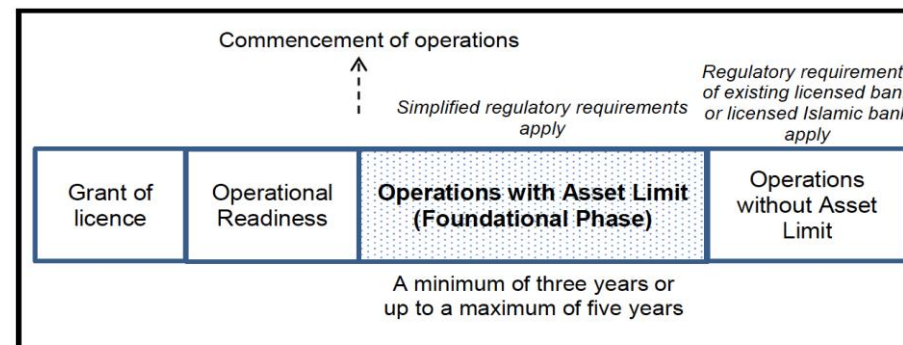
Objective of BNM to mandate foundational phase for digital banks: To enable the admission of digital banks with strong value propositions whilst safeguarding the integrity and stability of the financial system as well as depositors’ interests.

Length of the foundational phase: Up to 5 years from its commencement of operations.

Asset Limit: During the foundational phase, its total size of assets does not at any time exceed the limit of **RM3 billion (US\$727 million)**. After this phase, the asset cap does no longer apply.

MCR and Regulatory requirements:

- **MCR is RM100 million (US\$24.2 million)** during the foundational phase.
- Also, some simplification or exemption to the existing banking regulatory framework on prudential rules such as capital adequacy and liquidity are applied.
- By the end of the fifth year from the commencement of its operations, a digital bank must comply with all regulatory requirements applicable to an existing licensed bank or licensed Islamic bank and achieve a **MCR of RM300 million (US\$73 million)**.



Source: [Bank Negara Malaysia \(2020\)](#) and World Bank (Forthcoming).

III. PHASED AUTHORIZATION OF (DIGITAL) BANKS

Two examples of digital banks that took advantage of the phased authorization



United Kingdom

Monzo Bank was launched in 2015. It became a new bank and entered the “mobilization phase” in August 2016. Its main aim was to be fully licensed and turn their existing pre-paid card scheme into a full current account with debit cards, faster payments, direct debits, among others. After the mobilization phase, it was fully licensed in April 2017 and launched current accounts in October 2017. It is authorized by the Prudential Regulation Authority (PRA) and regulated by the PRA and the FCA of the UK. According to its website, some of the main areas of focus in terms of its social impact include:

- **Accessibility:** How does it make sure that Monzo really works for everyone?
- **Vulnerable customers:** How does it help customers in difficult situations stay in control of their finances?
- **Financial Inclusion:** How does it help as many people as possible get access to finance and make good financial decisions, particularly people who currently don't have access to banking?

Sources: [Our Social Impact](#), [Is Monzo a Bank?](#), [We are now a Bank](#), [The Next Step: Current Accounts](#)



Australia

In May 2018, it became the first digital bank to be granted a restricted ADI license by APRA. It was fully licensed in January 2019 as an ADI.

The digital bank is still in the [process of beta testing](#) and offers savings account to only a small group of people. It was also initially planning to launch consumer lending products. However, the digital bank recently announced a strategic partnership with Microsoft and tech provider LAB3 to create a [banking-as-a-service platform](#), which will allow businesses (e.g., fintechs) to offer banking products to their own customers.

Source: [APRA](#)

III. PHASED AUTHORIZATION OF DIGITAL BANKS

Summary – Restricted phase and phased authorization



In the **UK** and **Australia**, both countries that do not have a bespoke licensing regime for digital banks, **all banks** have **the option** to follow the restricted phase. In **Malaysia** and **Singapore**, both countries with a separate licensing regime for digital banks, **all digital banks** are **required** to go through a restricted phase before becoming a fully licensed digital bank, **while the regime of phased authorization does not exist for traditional banks**.



The **length of the restricted phase varies**. The period must be between 3 to 5 years for a digital bank in Malaysia. While MAS in Singapore does not predetermine a time period, it expects these digital banks to be fully functioning within 3 to 5 years from the commencement of business. However, the restricted phase for banks is shorter in the UK (up to 12 months) and Australia (up to 24 months).



While banks (both digital and traditional) in the restricted phase may be subject to **relaxations of existing regulatory requirements** as they apply to fully licensed banks, such as MCR or liquidity requirements, they face **certain limitations** on other measures such as:

- The size of the balance sheet
- The amount of total deposits that the new bank can collect from the public
- Limits on the aggregate deposit of an individual
- Permission to solicit deposits only from a limited group/number of customers
- Only being allowed to offer simple credit products and/or limitations on the amount of individual loans that can be offered by the bank

III. PHASED AUTHORIZATION OF DIGITAL BANKS

What is the potential of the phased authorization approach for advancing financial inclusion?

This approach could be of interest to and useful for fintechs which may need the restricted phase to **build IT systems and infrastructure, raise the required capital, recruit staff, bring on the expertise necessary, engage with third parties, and ensure their operations are fully compliant with all requirements.**

It allows applicants to **attract the required level of investment** during the restricted phase since funders are aware that the applicant is on the path to becoming a fully licensed bank.

Close engagement with the regulator during the restricted phase could make the licensing process easier for applicants to understand what the regulator expects from them – before becoming a fully licensed bank. This may positively impact the level of compliance of new banks during the restricted phase and later after becoming fully licensed.

As a result of all this, it may **enable the entry of small disruptive players**, which can offer more affordable products and services to the underserved taking advantage of innovative business models and lower operating costs. Also, the entry of an increased number of players can have a **positive impact on competition**. This may push the incumbents to respond to new entrants by improving their offerings with lower prices, greater choice and quality of service that better meet the needs of customers.

A phased authorization approach that **applies to any FSPs** including traditional banks, digital banks, and other licensed entities could have the potential to encourage the entry of inclusive players to the financial sector. The policy makers should delve into the potential impact of such an approach on financial inclusion.

III. PHASED AUTHORIZATION OF DIGITAL BANKS

What are potential limitations of the phased authorization approach?

In some models, restrictions on the new banks may **pose an obstacle against the growth of the business during the restricted phase**. An alternative approach for the regulators might be to identify restrictions depending on the profile of the individual applicant, its business model and financial projection, among others instead of putting prescriptive limitations on business. However, this would require the capacity of the regulator to sufficiently assess the risk profile of each applicant and prescribe requirements accordingly.

Also, a restricted phase may not be necessary for applicants that have everything in place for being fully authorized, including the sufficient capital, necessary resources and infrastructure at the time of application. A **mandatory restricted phase** would mean loss of time for such applicants and pose a challenge for their potential growth. It would delay the entry of players of entering the industry at scale.

If the **length of the restricted phase** is not long enough, some applicants may struggle with meeting the requirements in this short period of time and eventually lose their license. This may hurt consumer trust in the business model, and potential customers may not be willing to engage with banks/digital banks with similar business models.



IV. NO SEPARATE DIGITAL BANK LICENSING REGIME

IV. NO SEPARATE DIGITAL BANK LICENSING REGIME

Most countries neither have a bespoke digital bank licensing regime nor follow a phased approach to licensing of digital banks

A survey by the [Bank for International Settlements \(2020\)](#) among 31 jurisdictions confirms that most surveyed jurisdictions apply existing banking laws and regulations to digital banks, which means digital banks applicants need to follow the same licensing process and face the same regulatory requirements as an applicant with a traditional business model.

Some digital banks with a substantial customer base are already licensed under the existing banking regulations in countries that do not have a bespoke or phased licensing regime (e.g., in Brazil, Germany, South Africa).



IV. NO SEPARATE DIGITAL BANK LICENSING REGIME

South Africa's TymeBank was licensed under the existing banking regulations

- TymeBank was founded and built to bank the unserved and underserved mass market. It combines online experience through a mobile app with offline experience through partner grocery stores and offline and online access through kiosks.
- In June 2012, Tyme was established as an independent and stand-alone entity. In 2015, Commonwealth Bank of Australia through its subsidiary Commonwealth Bank of South Africa (CBSA) acquired a 100% stake in TymeBank and renamed it TymeDigital.
- The South African Reserve Bank (SARB) granted a banking license to CBSA (TymeDigital) in September 2017. TymeDigital was the first bank since 1999 to receive an operating license by SARB. In total, it took the bank three years to get the license. Three financial sector regulators were involved in the process: SARB (prudential requirements, including minimum capital of ZAR 250 million [US\$14.6 million]); the Financial Sector Conduct Authority (deposit taking, market conduct); and the National Credit Regulator (lending).
- South African financial sector regulators have adopted a risk-based approach and have been open to regular engagement with the industry. In TymeBank's case, the regulators demonstrated an ability to assess and approve a unique business model and operating structure of a bank with no branches.

Source: [Jenik, Flaming, and Salman \(CGAP 2020\)](#).

IV. NO SEPARATE DIGITAL BANK LICENSING REGIME

N26 as an example of a German digital bank without any special treatment in regulation

N26 started its activities as a fintech in 2013 and launched the initial product, i.e., free current account, in early 2015. Initially, it was operating without a banking license. It partnered with Wirecard Bank for the banking back end. During this partnership, N26 acquired more than 200,000 customers and raised substantial amount of funds.

However, partnerships with banks often are slow and difficult. N26 faced restrictions from the partnering bank. At some point, this started to pose a challenge for N26 to grow further and offer new products and services.

Eventually, N26 applied for a banking license and after a 9-month period, in July 2016, N26 was recognized as a fully licensed bank by BaFin (German Federal Financial Supervisory Authority) and the European Central Bank.

Germany's banking law does not offer a phased approach to licensing of banks. The route via a banking partnership - essentially a BaaS model - therefore was the best option to phase in full scale operations. It is hard to tell whether a phased approach might have made it easier for N26 to graduate to a fully licensed bank. N26 could have undergone the restricted phase, where it could attract more funding and already operate on a limited scale and try certain products and services without relying on a partner bank and dealing with limitations such a partnership might bring. But they might have been subject to other limitations such as the scale of their operations.

IV. NO SEPARATE DIGITAL BANK LICENSING REGIME

What about applying existing banking regulations to digital banks?

Licensing of all banks with a similar range of permitted activities under the same set of rules is clearer to applicants – regardless of whether they have branches or not and of the state of their technology adoption.

Such an approach creates a level playing field and closes the door to regulatory arbitrage between traditional banks and digital banks.

However, depending on the country context certain provisions of the existing banking regulations may be a constraint in implementing new technology-enabled business models. In such cases existing regulations should be revised. We recommend to review the existing regulatory framework to detect any such possible constraints. These could be, for example:

- Defining a bank as an entity with branches or requiring banks to operate through a minimum number of branches (although in some countries, this requirement is driven by financial inclusion objective of serving people in remote areas, yet agents should always be an alternative),
- Not allowing digital onboarding of customers,
- Restrictive shareholding rules that prohibit the entrance of diverse actors,
- Being too restrictive in outsourcing requirements,
- Not permitting the use of cloud service providers.



V.RECOMMENDATIONS FOR REGULATORS

V. RECOMMENDATIONS FOR REGULATORS

Steps to assess the appropriateness of current regulatory framework



Assess your existing regulations and whether they may pose obstacles against incumbents becoming digital and entry of new players adopting emerging digital business models, including the players that are not planning to conduct all activities permitted to banks. Regulations should be assessed with a view of implementing a proportional approach commensurate to the risks of digital banks: e.g., minimum capital requirements, rules on cloud-computing and other outsourcing relationships, digital onboarding, privacy, data protection, and cybersecurity, among others.



Consider implementing improvements to the existing licensing regime that could benefit any type of regulated FSP:

- Implement risk-based approach to licensing where entry requirements are set according to the types and levels of risks associated with activities conducted by the FSP.
- Also, consider whether a phased approach to licensing that applies to FSPs including both traditional banks and digital banks would be a better fit for welcoming inclusive players.



Consider whether it is possible to revise your existing regulations and/or to issue new regulations applying to traditional banks to address any existing constraints. It might suffice to revise or amend the existing regulatory framework for banks for the benefit of both the incumbents digitizing operations and new entrants that heavily operate digitally. If this is possible, it would be unnecessary to create a bespoke licensing regime.



If you already adopted a bespoke digital bank licensing regime, assess whether any rules and requirements specific to digital banks create competitive imbalances. Also, consider whether any regulations for digital banks could present obstacles for providers serving the unbanked/underbanked.

ACRONYMS

ADI: Authorized Deposit-taking Institution

AI: Artificial Intelligence

APRA: Australian Prudential Regulation Authority

BaaS: Banking-as-a-service

BaFin: German Federal Financial Supervisory Authority

BNM: Bank Negara Malaysia

CDM: Cash Deposit Machines

CDD: Customer Due Diligence

DFB: Digital Full Bank

DFS: Digital Financial Services

DRB: Digital Retail Bank

EMI: Nonbank E-money Issuer

FSP: Financial Services Provider

FCA: Financial Conduct Authority of the UK

MAS: Monetary Authority of Singapore

MCR: Minimum Capital Requirement

P2P Lending: Peer-to-Peer Lending

PRA: Prudential Regulatory Authority of the UK

SARB: South African Reserve Bank

SME: Small and medium sized enterprises

LIST OF REFERENCE REGULATIONS

Australia:

[ADIs: New entrants – a pathway to sustainability, Information Paper, August 2021, Australian Prudential Regulation Authority](#)

Hong Kong:

[Authorization of Virtual Banks, Hong Kong Monetary Authority](#)

Korea:

[Special Act on Internet-only Banks](#)

Malaysia:

[Licensing Framework for Digital Banks, December 2020, Bank Negara Malaysia](#)

Pakistan:

[Draft Digital Bank Regulatory Framework, State Bank of Pakistan](#)

The Philippines:

- [Manual of Regulations for Banks \(MORB\), Bangko Sentral Ng Pilipinas](#)
- [Circular No: 1105 - Guidelines on the Establishment of Digital Banks, Bangko Sentral](#)

Singapore:

- [Digital Full Bank, Monetary Authority of Singapore](#)
- [Frequently Asked Questions on Digital Full Bank and Digital Wholesale Bank Licenses Part I, Monetary Authority of Singapore](#)
- [Frequently Asked Questions on Digital Full Bank and Digital Wholesale Bank Licenses Part II, Monetary Authority of Singapore](#)

Taiwan:

[Standards Governing the Establishment of Commercial Banks](#)

United Kingdom:

[New Bank Start-up Unit, Prudential Regulation Authority and Financial Conduct Authority](#)

REFERENCES

Banking as a Service: reimagining financial services with modular banking, Report, 11FS (2021) <https://11fs.com/reports/banking-as-a-service>

Choi, Youjin. 2020. “Digital Banks: Lessons from Korea.”, World Bank, Brief. October.
<https://documents.worldbank.org/en/publication/documents-reports/documentdetail/579871603861444098/digital-banks-lessons-from-korea>

Ehrentraud, Johannes, Denise Garcia Ocampo, Lorena Garzoni and Mateo Piccolo. 2020. “Policy Responses to Fintech: A cross-country overview.” Financial Stability Institute Insights No 23. January.
<https://www.bis.org/fsi/publ/insights23.pdf>

“Evaluation Paper 18/3: An evaluation of reducing barriers to entry into the UK banking sector.” 2018. Financial Conduct Authority. December.
<https://www.fca.org.uk/publication/corporate/ep18-3.pdf>

Hernandez, Emilio. 2019. “The Role of Cash In/Cash Out in Digital Financial Inclusion.” CGAP. Blog. July. <https://www.cgap.org/blog/role-cash-incash-out-digital-financial-inclusion>

Jenik, Ivo, Mark Flaming and Arisha Salman. 2020. “Inclusive Digital Banking: Emerging Markets Case Studies.” CGAP. Working Paper. October.
<https://www.cgap.org/research/publication/inclusive-digital-banking-emerging-markets-case-studies>

Kerse, Mehmet and Ivo Jenik. 2020. “Some Countries Have Digital Bank Licenses, Others Have Digital Banks.” CGAP. Blog. November. <https://www.cgap.org/blog/some-countries-have-digital-bank-licenses-others-have-digital-banks>

Rabadan, Guillermo Garcia, Harish Natarajan, Rekha Reddy, and Matei Dohotaru. 2021. “Digital Banks: The Experiences so Far, Opportunities and Challenges.” World Bank (Forthcoming)

Salman, Arisha, and Ivo Jenik. 2020. “What Makes Digital Banking Inclusive?”. CGAP. Blog. November. <https://www.cgap.org/blog/what-makes-digital-banking-inclusive>

