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THE ROAD AHEAD FOR ASIA'S DIGITAL BANKS

Takeaways from the Elevandi Insights Forum 2022

With contributions from Oliver Wyman

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SFF brings together the global FinTech community to engage, connect, and collaborate on issues relating to the development of financial services, public policy, and technology. For more information, please visit www.fintechfestival.sg

The theme of the Singapore FinTech Festival 2022 (SFF2022) was *Building Resilient Business Models amid Volatility and Change*. Key stakeholders comprising government leaders, regulators, financial services leaders, entrepreneurs, investors, digital asset firms, and technology leaders explored this theme across three key questions:

VIABLE

How are organisations building and redefining business models that can be more resilient to volatile market conditions?

RESPONSIBLE

How are organisations balancing corporate responsibility and profitability in order to achieve greater stakeholder satisfaction and engagement?

INCLUSIVE

How are organisations designing inclusive business models that cater to the needs of the unbanked and underbanked?

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INTRODUCTION

The Asian digital bank CEO strategic roundtable provided a deep dive on the maturity of digital banking, and for the first time, brought together CEOs from leading digital banks across Asia to discuss growth opportunities, regulatory implications, and their lessons learnt along the digitalisation journey. Participants discussed how key risks and challenges could be managed while maintaining profitability through the following themes:

Theme 1: Evolution of financial services, from products like payments to lending

Theme 2: Driving financial services evolution via innovative technology architecture

Theme 3: Role of open and trusted data to drive financial services evolution

Theme 4: Attracting, training, and retaining talent

Theme 5: Policy expectations from regulators

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EXECUTIVE SUMMARY

This report provides a summary of key issues at the top of mind for CEOs from leading digital banks across Asia. Digital banks have been a growing industry in recent years within the region, with many either having successfully launched, or are building towards a launch in the next few years. At the Elevandi Insights Forum 2022, CEOs from these digital banks shared sentiments on opportunities for growth, regulatory implications, and their lessons learnt along the digital bank journey. While many topics were discussed during the session, they are best summarised across the five key themes detailed below:

Theme 1: Evolution of financial services, from products like payments to lending
With a bleak global economic outlook and liquidity drying out, profitability has shifted to be front and center of mind for Asian digital bank CEOs. While reaching the underbanked or unbanked is a key driver to gain traction within the market, lending has proved to be the secret sauce towards a winning and profitable strategy for digital banks.

However, in order to unlock the full potential of lending, digital banks have to be creative to overcome the hurdle of the underbanked or unbanked not having traditional data points for underwriting decisions. To help them achieve success, some digital banks have turned to incorporating alternative data sources to better price the risks associated with lending to these types of customers, and thereby make informed underwriting decisions, such as approval and pricing.

Theme 2: Driving financial services evolution via innovative technology architecture
Innovation is key for bringing value in terms of products and services to digital bank customers. Hence, the foundational architecture of a digital bank needs to be modular to allow rapid testing and launching of new products, and secure exchange of data with ecosystem players. Achieving this successfully would enable digital banks to reap various benefits. For example, they would be able to consume and share data across organisations and ecosystem players to hyper-personalise products and services. They could also leverage alternative data from ecosystem partners to underwrite loans for the underbanked and unbanked, and utilise open architecture for the ease of connecting to ecosystem partners so as to expand their distribution channels for banking services.

While the benefits are apparent, Asian digital bank CEOs have identified several common pitfalls. These include developing unique propositions due to customisation, keeping vendor costs low as a main driver towards profitability, and launching product differentiators at the start to help them rise above the competition.

Theme 3: Role of open and trusted data to drive financial services evolution

Open and trusted data, such as a national identity database, enables digital banks to reap the benefits of an open ecosystem to effectively serve their underbanked and unbanked target customers. The pros range from simplifying banking processes such as onboarding, and reducing risk by utilising a unified identity database to prevent fraudsters from using fake identities, to reducing service costs by leveraging trusted sources instead of having to undergo hefty compliance processes.

Governments and regulators need to quickly establish these digital utilities if they have not already done so, in order to reap the full benefits of digital banks and the open ecosystem.

Theme 4: Attracting, training, and retaining talent

Attracting talent is one of the most pertinent challenges that Asian digital bank CEOs need to solve. With talent being a key driver of success, Asian digital banks must develop the right talent value proposition to attract and retain the best talents. The participants concurred that several key areas they wish to focus on are building and maintaining the right work culture, developing a core employer proposition that is compelling to the target talent pool with flexibility based on the employees' preferences, and utilising greater performance-based incentives to attract and motivate the right talent.

Theme 5: Policy expectations from regulators

Regulators have taken a positive step forward with the issuing of digital banking licenses. However, further evolving regulations would enable countries to embrace even more benefits from digital banks and improve the banking industry as a whole. While regulation changes could be introduced in various shapes and forms, a conducive regulatory environment for digital banks would include supporting efficiency to lower unit economics by embracing sandboxes to drive innovation, and enabling better collaboration and infrastructure within a country and across the region, thereby facilitating a level playing field with incumbent banks.

THEME 1: EVOLUTION OF FINANCIAL SERVICES, FROM PRODUCTS LIKE PAYMENTS TO LENDING

With the global economy taking a downturn and investors tightening their liquidity, profitability has become top of mind among Asian digital bank CEOs. At the Elevandi Insights Forum 2022, minimising costs while prioritising products that have positive unit economics was the theme of the conversation, all under the umbrella of solving key issues and problems for Southeast Asia's underbanked and unbanked population.

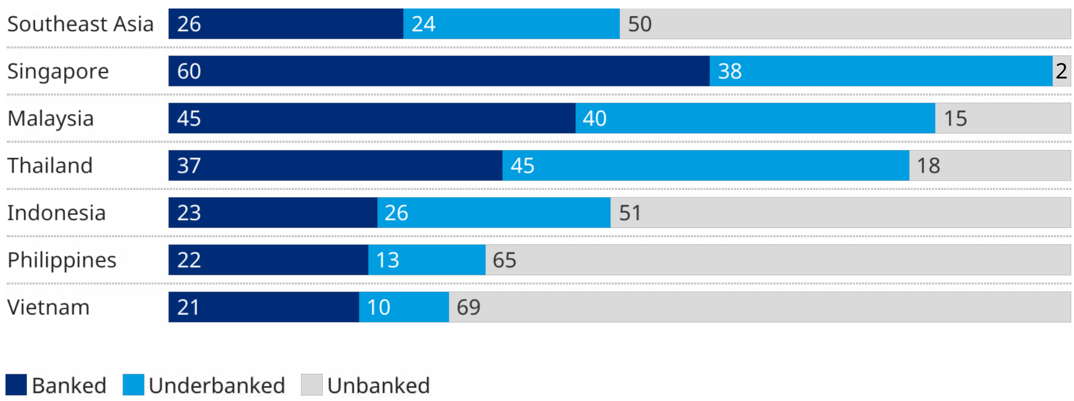
FROM E-WALLETS TO DIGITAL BANKS

Of the world's adult population, 24% is unbanked, with 1.4 billion[1] adults not having access to a bank account. In Southeast Asia, this proportion increases to about 50%[2], with a further 24% estimated to be underbanked. The underbanked refers to adults who have a bank account, but who still lack access to all other financial services, such as lending or a means of saving. While the focus is on expanding services, it is also important to provide credit education to these new underbanked customers to ensure they understand the risks of borrowing and avoid making uninformed decisions.

1 World Bank. COVID-19 Boosted the Adoption of Digital Financial Services.

2 Temasek. Fulfilling It's Promise: The Future of Southeast Asia's Digital Financial Services.

Exhibit 1: More than 70% of Southeast Asia's adult population is underbanked or unbanked



Banked	Underbanked	Unbanked
Well served in financial services needs Have access to credit cards, underinsured, no long-term savings products	Not well served in financial services or have unmet needs No access to credit cards, underinsured, no long-term savings products	No access to basic financial services (a bank account)

Source: Temasek

E-wallets were one of the first players to look to serve the underbanked, providing a quick and easy way for customers to set up a wallet, deposit money, and use the wallet for payments. E-wallet providers today range from banks and telecommunications providers, to big tech companies. With Malaysia alone housing 53 of the approximately 150 ASEAN e-wallet providers, the e-wallet market is crowded.

LENDING IS KEY FOR THE UNDERSERVED

E-wallets are primarily used for payments, such as to pay bills, send money to friends, and pay businesses at the point of sale, and represent an initial step on the road to improving financial inclusion in the region. However, to help both unbanked and underbanked customers, along with the gross domestic product of ASEAN countries in general, access to lending is key for the coming years. A recent Oliver Wyman survey found that 34% of the customers surveyed would not apply for a loan, believing their bank would not lend to somebody in their position. A further 32% of that same sample said they would not make an application as there are too many paper forms to complete. Even before the rejection of the underbanked, there is enough negative perception and few frictional processes to encourage them even trying.

Exhibit 2: Gap between demand and formal supply, and impact of digital applications

		% of Need met by formal FS providers Calculated as % of total need in the segment	**Gap addressable by digital finance** % of total gap	**Need vs. Formal Supply Gap** In US$ Billion
Payments/ Transfers	ID	35%	37%	144
	PH	75%	44%	16
	CB	40%	35%	5
	MM	11%	30%	20
Credits	ID	64%	20%	57
	PH	48%	21%	21
	CB	72%	19%	3
	MM	48%	28%	2
Savings	ID	74%	35%	37
	PH	60%	38%	20
	CB	16%	12%	22
Insurance	ID	1%	Not estimated due to nascent stage of Micro-insurance market development	0.7
	PH	4%		0.7
	CB	2%		0.0

Note: We are not able to reliably estimate formal savings and insurance supply in Myanmar that targets financial inclusion sub-segments.

Source: Oliver Wyman Analysis

With both retail consumers and 60% of the 71 million micro, small, and medium enterprises (MSMEs) in Southeast Asia struggling to get business financing from traditional financial institutions[3], lending seems to be a big opportunity for digital banks in the region.

SUCCEEDING THROUGH UNSECURED LENDING

Globally, unsecured lending has been the winning strategy for digital banks, as, compared with fee-based products, strong interest income has proven to be a strong driver of profitability for profitable digital banks.[4] This is in turn supported by focusing on BaaS and embedded financial solutions to bring distribution costs down. Of the 252 digital banks worldwide, only about 5% are profitable.[5] Among the top 10 digital banks globally, the profitable digital banks are those that lead with unsecured lending propositions.[6] It is evident that payments and savings pots alone cannot make you a profitable bank, as many European digital banks discovered in their early years.

3 Southeast Asia Development Solutions (SEADS). Realizing the Potential of Over 71 Million MSMEs in Southeast Asia.

4 S&P Global. Strong interest income tips the scale for digital banks in Europe, Asia.

5 The Financial Brand, Fintech News Singapore, Fintech News Switzerland, N26.

6 Company websites, Comparably, DigFin, NPS Prism, LABS.

Exhibit 3: Of the top 10 digital banks globally (by number of customers), the four profitable banks lead with lending propositions

Bank	Type	Country	Launch	Customers In millions	Profitable
WeBank	Regional	China	2014	343	Yes after 1 year
Nu Bank	Regional	Brazil	2013	65	No
Paytm	Regional	India	2010	65	No
MyBank	Regional	China	2015	45	Yes after 1 year
Revolut	Global	UK	2015	21	No
Banco Inter	Regional	Brazil	2015	21	No
Tinkoff Bank	Regional	Russia	2006	20	Yes after 3 years
KakaoBank	Regional	South Korea	2016	18	Yes after 2.5 years
Neon	Regional	Brazil	2016	16	No
Chime	Regional	USA	2013	13	No

Source: Company websites, Comparably, DigFin, NPS Prism, LABS, Fincog

Lending to the masses or emerging masses is a crowded strategy. Incumbents have been lending to creditworthy customers in Southeast Asia for decades. The opportunity lies in the underbanked and unbanked, but there are clear reasons why lending to this market is hard. They do not provide traditional data points that the mass market offers for making underwriting decisions, such as bureau scores or regular pay slips. Therefore, to win in this segment, players need to get creative with alternative data sources in order to underwrite the risk that comes with lending to these customers. Such data can come from conglomerate partnerships, ecosystems, government agencies, or even e-wallets. Combining this alternative data with a customer's particulars may allow digital banks to price the risk associated with lending to them. Digital banks also need to focus on driving revenue via volume growth, given that the ticket sizes of loans to this segment are generally smaller in nature.

Additionally, there is still the hurdle of getting the alternative underwriting model approved by the respective regulators in Southeast Asia. On the one side, regulators need to be cognisant of the higher credit risk associated with the underbanked and unbanked segment, while on the other side, they need to work closely with regulators to find innovative ways to serve these customers. Ultimately, managing the risks appropriately will be key.

THEME 2: DRIVING FINANCIAL SERVICES EVOLUTION VIA INNOVATIVE TECHNOLOGY ARCHITECTURE

At the Asian digital bank CEO strategic roundtable, participants agreed that to foster innovation in terms of products and services that customers love, the foundational architecture of a digital bank should be modular to allow for rapid testing and launching of new products and features, and secure exchange of data with ecosystem players. Doing so would both open new revenue opportunities for the digital banks and make the path to financial services evolution easier to navigate.

THE PROS OF MODULAR, OPEN ARCHITECTURE

The typical aim for greenfield digital banks is to build fully modular, cloud native, open architecture. Doing so would enable digital banks to do the following:

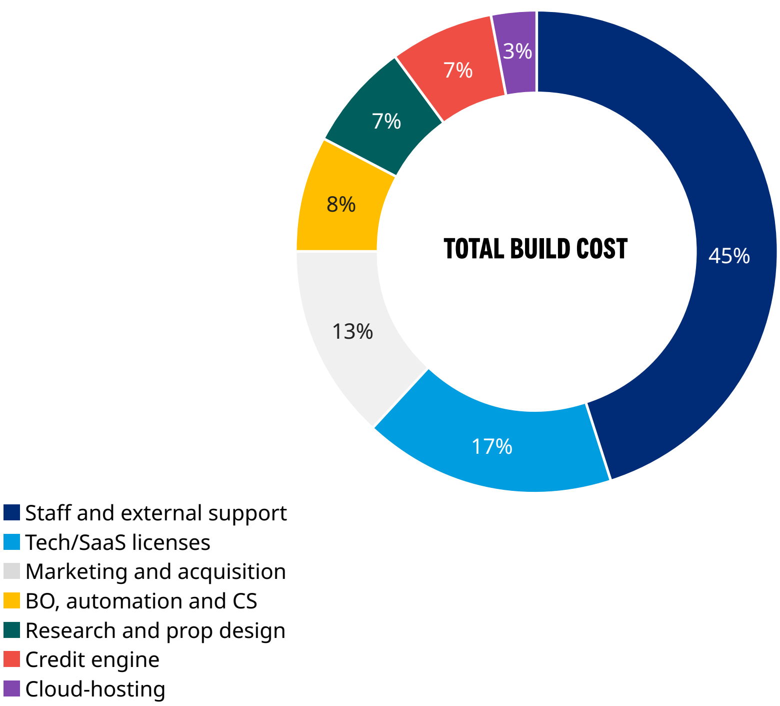
Capture, centralise, and utilise customer data in order to offer hyper-personalised products and services.
By building their technology stack with standardised open APIs, digital banks can consume and share data across the organisation, or even with their parent companies and ecosystem partners, if permitted by regulators. Such data sharing would allow, for example, fintech companies to provide customers with additional financial services, technology providers to provide better infrastructure or platforms, and payment providers to provide seamless payment options. It would also allow the bank to centralise and analyse the data for the personalisation of customer experiences and the development of new customer-focused products.

Underwrite loans to the underbanked and unbanked with alternative data captured from outside sources.
Through open architecture, banks get the full benefit of ecosystem partner relationships through the ability to consume live data from partners. One area where this would have a large benefit is in the underwriting of loans for the underbanked and unbanked. Ecosystem partnerships with e-wallets, telecommunications companies, credit bureaus, and digital ecosystems would enable digital banks to consume the alternative data needed to price the risk of lending to these types of customers.

Easily connect to ecosystem partners to expand distribution channels by embedding their lending and payment services in partner ecosystems.
Open architecture allows digital banks to plug their products directly into the purchasing journeys of their ecosystem partners' customers, giving them the ability to offer products such as loans, "buy now pay later" promotions, or payment services directly in partner ecosystems. For example, a digital bank could embed its APIs into an ecosystem partner's customer journey to offer the bank's banking services as a cross-selling product to bring value to the customer. This action would allow the bank to increase its balance sheet and transaction volume without significantly increasing its variable costs.

Achieving this target state is neither quick nor easy. Building a bank is expensive and difficult to do quickly if you want to get it right the first time round. Our experience in the Asia-Pacific region suggests that a total build cost of US$20-45 million is required for a new digital bank, of which US$3.5 million up to US$7 million could be allocated to vendor costs.

Exhibit 4: Breakdown of typical total build cost to launch a digital bank to market



Source: Oliver Wyman analysis

KEY LESSONS AND COMMON PITFALLS

The following are some key lessons learnt and common pitfalls that can be avoided when building a new digital bank:

Evaluate the suitability of bank-in-a-box solutions

This is the pitfall that most of the CEOs present experienced when trying to get to market fast. Each digital bank player wants to be differentiated, and therefore has different requirements when it comes to building its proposition. The differentiational aspects of the proposition require customisation by vendors, and so will in turn increase build and licensing fees. However, one of the key benefits of bank-in-a-box solutions is that they are pre-configured to readily deliver basic banking services.

Vendor costs are typically higher than expected, raising the bar for profitability

The majority of the vendor costs are fixed build costs. When building a bank, it is very easy to end up with more than 15 vendors, each with their own recurring licensing fees. It is therefore important for a digital bank to keep the following four profitability-related questions in mind when absorbing vendors into its architecture:

- Is it necessary for this aspect to be regulatorily compliant, and can the vendor guarantee compliance?
- Does this vendor enhance my customer offering, and is it crucial to my proposition and strategy?
- How much of the vendor’s standard offering do I need to customise?
- Am I doing this purely for speed, or can we build this ourselves?

Building the base is a necessity, but customers will not come to you for basic products

Many ASEAN digital banks have launched with a basic proposition. They prefer to get to the market with a minimum viable product (MVP) and then go from there. While there are many success stories in scaling from an MVP historically, as the market matures and becomes increasingly competitive, a plain vanilla MVP may no longer be enough to gain a foothold with today’s digital consumer. Savings pockets, personal finance management, and payments do not differentiate digital banks from the competition. They are the basic expectations of customers. Therefore, new digital banks should be aggressive in their initial launch plans to differentiate themselves from the pack. Besides the basics, they need to offer the market points of differentiation from day one.

THEME 3: ROLE OF OPEN AND TRUSTED DATA TO DRIVE FINANCIAL SERVICES EVOLUTION

In terms of serving underbanked and unbanked customers, forum participants agreed that the key was open and trusted digital utilities, such as national identity databases like Singapore's Singpass to support eKYC, and India's India Stack for payments and credit enablement. These utilities would provide accessibility, affordability, and trust of banking services, as well as data for both banks and customers. National identity databases would provide banks the added security of being able to access data to confirm a customer's proof of income and other details, enabling more affordable banking services for the underbanked through accurate and accountable data with which to assess risk. Currently in markets without accessible identity databases, digital banks are experiencing higher onboarding costs due to low eKYC success rates, and the high potential for the opening of fraudulent accounts. Governments and regulators need to quickly establish these digital utilities if they have not already done so, in order to reap the full benefits of digital banks and the open ecosystem.

KEY BENEFITS OF OPEN, TRUSTED DIGITAL UTILITIES

Some of the key benefits to digital banks of open and trusted digital utilities include the following:

Simplified processes
Reliable digital identity database utilities are key to making a robust open-data ecosystem operational and implementing related services such as effective digital KYC processes, as they allow people to prove their officially recognised identity online rather than in person. This reduces the onboarding time for customers and the KYC burden on banks.

A best-in-class example of this is seen in Singapore, where they have established Singpass, their national digital identity database, and API Exchange, the government's data sharing platform, which have helped to improve the lives of residents and drive their Smart Nation initiatives. About 97% of the eligible population uses the Singpass application to access over 2,000 public and private sector services online, ranging from their banking apps, to healthcare, education, and transportation. Particularly for banking, this has resulted in a seamless customer journey for opening a bank account in Singapore, with some Singaporean banks requiring only 20 to 30 clicks to open a bank account, significantly lower than the 40 to 120 clicks or even more of many banks from other countries.[7]

Besides open identity management, open data can simplify other processes, such as loan underwriting, allowing banks to take outside data from other financial bodies, such as credit agencies and other banks, to evaluate the risk of lending to an individual customer. This reduces the amount of document ingestion a bank may have to do through optical character recognition or other paper to digital processes.

Reduced risk

Digital banks across ASEAN have seen numerous fraud attempts. Within Asia, there has been consistent growth in fraud attempts, fuelled by the shift to digital systems. Digital fraud attacks, particularly on mobile channels, have surged 94% year-on-year worldwide.[8] This is an issue particularly during the account-opening phase of the digital banking journey. Fraudsters attempt to open bank accounts with fake identities in order to fund and run nefarious operations, or profit from identity fraud in that country. While eKYC vendor solutions attempt to reduce this risk with liveliness tests and their own database utilities, the success rate of these solutions is only around 30% in some ASEAN countries. This defeats the purpose of digital banks in places such as Indonesia or Malaysia, where the majority of the underbanked and unbanked often live in remote locations. The use of government identity database utilities can remove this risk and further the positive impact of digital banks on the underbanked and unbanked.

Reduced cost to serve

Open data also reduces the cost to serve so that banks can both progress to more profitable models, and service the underbanked and unbanked segments. KYC costs, for example, make up approximately 3% of a bank's total operational cost base. Open data sharing and exchange between trusted sources can help eliminate the hefty KYC compliance cost, saving banks millions of dollars a year and improving the overall customer experience, all without compromising security.

7 CFTE. The Importance of Customer Experience in Digital Banking.

8 Hubbis. Rising Digital Fraud Attacks in Asia Pacific.

THEME 4: ATTRACTING, TRAINING, AND RETAINING TALENT

Forum participants agreed that talent-related matters are among the most pertinent challenges to solve. Both traditional banks and new digital banks and fintechs are walking a tight rope to find the right talent value proposition to attract and retain the best talent. The participants agreed that they must focus on several key areas going forward to address the issue. Firstly, they must focus on their work culture, building and maintaining it, and ensuring new hires are truly a fit for their culture. Secondly, they need to step away from traditional base compensation schemes and move towards compensation schemes that are linked to performance, such as providing stock options, to not only drive performance but filter candidates that are confident in their ability to build a next-generation organisation. They also need to provide the right environment for employees to learn, grow, feel empowered, and build something they find meaningful.

STRONG COMPETITION FOR THE SAME TALENTS

As the financial industry moves towards a digital environment, new digital banks and fintechs are competing to attract the same talents from a limited pool that incumbent banks also traditionally target, stretching the talent pool thin across both the old and new players.

Due to the rise of fintechs and digital banks in Southeast Asia, 67% of hiring managers at financial institutions in the region are having trouble finding qualified talent.[9] Traditional banks have stopped being the preferred employers for tech talent as digital banks and fintechs have ramped up their offerings across not only compensation but culture, fit, and the prospect of creating something new and meaningful to attract outstanding candidates. Given that tech talent can be hard to come by in Asia, this forces banks to look for talent overseas in a bid to fill the skills gap.

9 Tech Wire Asia. Talent war in Southeast Asia due to fintech boom.

COMMON INDUSTRY-WIDE LEARNINGS

Though issues faced by traditional banks and up-and-coming fintechs may vary, common learnings include the following:

Building the right work culture is essential

This includes emphasising the values of digital culture, such as collaborative ways of working, agile development, openness to engage broadly with diverse sources of information and external networks, and customer centricity where the focus is on meeting the needs of new and existing customers. Developing and retaining this culture is key for attracting and retaining the right talent, particularly among the younger generation and tech sector hires.

Though it is relatively easier to build the desired culture when starting out small, this becomes increasingly challenging to maintain as an organisation grows. Having the resilience to put all hires, even CXOs, through a strong culture interview to help maintain the right culture is something employers can do to tackle the issue. Ensuring leadership believes in the desired work culture and promotes it with drive and passion will naturally permeate it throughout the organisation.

According to some studies, the top reason (62%) people quit their job was poor company culture, followed by salary, and poor management.[10] Within ASEAN, only 55% of employees say their employer is meeting all their needs across culture, upskilling, and talent trends in general.[11]

It is important to develop an employee proposition that is compelling to target talent pools so as to attract, retain, and engage the desired employees.

Employees of different generations, genders, and backgrounds provide various forms of value to the organisation and are integral to its success, yet at the same time they might have varying expectations of an attractive employee proposition.

In developing the organisation's employee proposition, the core value proposition should be centred around key personas to help identify what matters most to the organisation's target employees. However, at the same time, the organisation needs to be cognisant of the varying preferences across employee demographics and so provide flexibility as well.

10 Flex Jobs. Great Resignation: Survey Finds 1 in 3 Are Considering Quitting Their Jobs.

11 Mercer. From the Great Resignation to the Great Burnout, employers in Asia continue to grapple with shifting employee priorities.

For example, millennials and Generation Z employees expect more flexibility with regard to working options than their Generation X counterparts.[12] While the organisation should provide compelling workplaces where employees want to be as a core proposition, being flexible regarding working arrangements could be a middle ground that caters to its younger employees' preferences.

Greater performance-based incentives would be the right move

While it is easy to benchmark compensation against the industry, creative incentive structures have been effective in attracting new talent.

Traditional banks are playing catch up to up-and-coming fintechs and start-ups which consistently offer attractive compensation packages. What has been successful is stronger performance or output-linked compensation components in the form of stock options or similar share programmes.

What some organisations have found to be most effective is competitive share programmes. These have allowed the organisations to filter and acquire the ideal talent for themselves. Particularly, individuals that opt into a lower fixed component and higher share upside tend to be those you want on your team and are personally driven beyond just personal success. This is seen in one in three organisations, where the reason for offering equity compensation is to attract and retain talent, and about 35% of public companies are offering discounts on stock purchase programmes.[13]

However, this must also be balanced with traditional compensation structures in incumbent banks. Some traditional roles will still be filled by those from incumbent banks and not everyone may want to have their compensation tied to performance.

ORGANISATIONS SHOULD ADAPT SOLUTIONS AS NEEDED

Despite these learnings, there are still challenges and tweaks to be made as no solution is ever perfect. Some organisations have shown a preference for hiring younger staff to better grow and develop the organisation's culture, while others have found the need to balance traditional banking backgrounds with new tech backgrounds. In addition, given the coverage of digital banks across regions such as Southeast Asia, organisations should be mindful to ensure they adapt to diverse backgrounds as preferences vary across countries.

One thing for certain though is that while the first place to look to solve talent issues is compensation packages, the talent landscape is evolving and people are looking for a more diverse offering from their employer, whether it is a culture fit, personal development opportunities, or compensation that is more intricately linked to personal performance.

12 Live Career. Different Generations in the Workplace | 2023 Study.

13 SHRM. Companies Ramp Up Stock Compensation to Compete for Talent.

THEME 5: POLICY EXPECTATIONS FROM REGULATORS

Forum participants agreed that regulators have a strong role to play in shaping the future of the industry. As an example, it was noted that the issuing of digital banking licenses was a positive change for the region. One of the biggest breakthroughs in regulation recently was the switch from rules-based to risk-based approaches for KYC, which allowed opening the problem up for a range of innovative solutions. This topic was followed up by examining wish lists for the future of regulation. The key areas discussed include regulations to enable efficiency as the underserved population begins to be served through innovation and technology, the use of sandbox environments for testing new types of innovation alongside regulators for added comfort in their usage, the expansion of infrastructure and collaboration efforts even across borders to better protect customer data and expand capabilities (for example, collaborative efforts such as SWIFT), and facilitating a level playing field between digital and incumbent banks.

THE REGULATORS' MAIN OBJECTIVES

Regulators of course play a key part in shaping policy within their respective geographies as the industry evolves with new upcoming digital banks and fintechs. With the introduction of digital bank licenses, the goals of regulators tend to be towards three objectives, namely, improving financial inclusion, consumer protection, and positively disrupting the existing financial industry.

Until recently, banking globally had been a closed system where the incumbents faced minimal challenges and had minimal impetus to change, resulting in limited innovation of technology, services, and infrastructure. Digital banking licenses signal a policy shift that can push for disruption but this is still only the beginning. Further work needs to be done to ensure continued success and that the drive for change persists.

One of the biggest regulation breakthroughs has been the shift from a rules-based approach to a risk-based one for KYC practices, which has allowed the world to open and become more creative in solving the same KYC problems. Shifting from a strict set of rules to a risk-based continuum has allowed for the development and utilisation of innovative approaches to improving KYC processes. This is just one example of how evolving regulation can enable and foster innovation within both incumbent and digital banks in the industry.

THE GOALS OF NEW REGULATIONS IN FUTURE

Looking to the future, we see the following goals of new regulations to tackle to positively impact both incumbent and digital banks:

Efficiency

Regulations supporting efficiency are necessary as the industry transitions towards a digital landscape. At the end of the day, the goal of financial inclusion boils down to a game of lowering unit economics and chasing scale while maintaining the best customer experience. Policies that enable efficiency will be required when it comes to being applied to things occurring millions of times across bank customers' day-to-day actions, such as opening accounts and making payments. Policies favouring efficiency are not to necessarily just be nice to digital banks and fintechs. Rather, every little step matters when scaling up to properly serve the smallest businesses and poorest consumers in the market.

Indonesia, with a population of about 270 million, currently estimates that 75% own a mobile phone, but only 50% have a bank account and a negligible number have access to credit cards.[14] As digital advancements improve financial inclusion, the support of regulations to help improve efficiency in handling this new influx of customers will be required.

Importance of sandboxes

Sandbox environments provide a critical space for both organisations and regulators. Digital trends tend to start suddenly and move quickly, and the ability of regulators to react and develop policies to account for these areas of innovation needs to be in place to act quickly. Having a space for organisations to try new things will speed up the process and time that regulators typically need to get comfortable with new things and develop appropriate regulations around them.

On the ground, experiences with regulatory sandboxes have been positive and seen to be beneficial to both regulators and financial ecosystems. Though difficult to directly attribute to the use of sandboxes, Thailand as an example has several in place for various aspects of the financial system. Since their implementation, new regulations surrounding robo-advisory, peer-to-peer lending, eKYC, and QR payments have been made. There have also been improvements in line with Thailand's "4.0" national strategy, improvement in Thailand's global talent competitive index, and growth in the number of venture capital firms in the market.[15]

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14 WEF. How to close Southeast Asia's financial inclusion gap.

15 World Bank. Global Experiences from Regulatory Sandboxes.

Enabling better collaboration and infrastructure

As the market evolves with the cost of capital rising, Web 3.0 coming into play, and faster payments emerging across countries, there will be a need for policies that both make infrastructure cheaper and promote collaboration.

Many fraudulent activities are common data. Rather than just cheat just one bank, fraudsters cheat many banks. Having national infrastructure and data utilities to help reduce the cost and risk of fraud for all involved to benefit can reduce the risk passed to the end-customer and improve the overall industry.

Furthermore, cross-border collaborations and infrastructure would also further drive value and synergies within the industry. Incumbent banks have had the advantage of being able to grow through cross-border collaborations such as SWIFT, but we have yet to see something similar for fintechs. There are opportunities to align regulations across countries to enable such collaborations and scale up capabilities across borders. For example, aligning eKYC guidelines across the region would enable regional digital banks to build a single system across various countries instead of having to implement multiple instances of the same capabilities tailored for varying guidelines.

Further facilitating a level playing field

In several ASEAN markets where digital banking licenses have been granted, restrictions have been placed on the successful licensees to maintain a level of initial safety to the public and their funds. Examples of these measures include capital requirements similar to incumbent banks, and limited access to ATM networks and other infrastructure. In the coming years, as digital banks prove their reliability, regulators should take another look at these measures and provide specific amendments, as needed, for digital banks to succeed.

FINAL THOUGHTS

Focusing new regulations on tackling these bottlenecks will help speed up innovation and the capability to serve the financially underserved efficiently and safely. Though some challenges can be resolved through the independent implementation of policies for respective geographies, there are opportunities for some regulators to play a more meaningful role and engage regulators across the region to foster collaboration and alignment to better enable the financial industry.

While digital banks and fintechs have a long road ahead in reaching out and improving financial inclusion, the journey should be walked together with regulators in the region in order to provide the best solution to customers.

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