

Regulating Digital Banks

The entry of digital banks to the Malaysian banking landscape is expected to foster innovation and enhance the provision of financial services to the underserved and unserved market segments.

At the same time, the Bank recognises that digital banks are likely to introduce new business models that are highly reliant on: (i) digital distribution channels; (ii) data analytics to drive risk profiling and customer relationships; and (iii) the use of third-party service providers to enhance customer reach and experience. This warrants increased focus on managing cybersecurity and technology risks; the responsible use and protection of customer data; and risks arising from partnerships with third parties. Where appropriate, prudential standards applied to digital banks will be proportionate to address these risks, while ensuring that any risks to financial system stability are well mitigated and customers are adequately protected.

In the initial or 'foundational' phase of operations, the digital banks will be subject to a simplified regulatory framework commensurate with asset size limits imposed on their activities. Under this phase, certain regulatory requirements relating to capital adequacy, liquidity, stress testing, Shariah governance and disclosures have been adapted to allow for less complex applications, while generally preserving the same level of prudence applied to other banks. On the other hand, digital banks will be required to demonstrate the ability to meet higher expectations in the management of technology and operational risks that reflect the unique risks of digital banks. For example, given the absence of physical premises to fall-back on, digital banks will be expected to observe higher standards for operational resilience and demonstrate that they can recover swiftly from business disruptions across all their activities. Resources and approaches directed by digital banks to deploy, maintain, review and update cybersecurity controls by third parties must also be consistent with the criticality of the services to the digital banks' operations.

Over the course of the foundational phase of the initial three to five years of digital banks' operations, the Bank's supervisory resources will focus on assessing the sustainability and scalability of the business models and technology infrastructure, as well as the effectiveness of the controls and risk management practices of digital banks in delivering their value propositions. A particular area of emphasis – both from a business viability and operational standpoint – will be on the management of outsourcing risks, especially in cases where there is high reliance on multiple business partners or third-party service providers. Digital banks are also required to establish an effective exit plan to ensure that the business can be wound down in an orderly manner without the use of public funds and causing market disruptions. This will also protect customers from being adversely affected if a business model or innovation is unsuccessful.

The five licensed digital banks are currently undergoing a preparation period prior to an operational readiness audit by the Bank before operations can commence. The audit will ascertain that the organisational structure, policies, procedures and controls, IT and accounting systems, business continuity plan and other relevant aspects of the digital banks' operations are in place and meet the relevant regulatory requirements. This process may take between 12 and 24 months.