Expert Insights

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Virtual banking is disrupting Asia's financial services

What is the role
for traditional banks?

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Talking points

Virtual banking
The creation of virtual banks in Singapore is driving fundamental reshaping of the banking ecosystem.

New trend in banking
Virtual banks have already been established in the US, UK, South Korea, and Hong Kong.

Stringent requirements
Addressing regulatory, compliance, and security requirements are key to the success of new virtual banks.

Potential disruption in banking

The recent announcement by the Monetary Authority of Singapore (MAS) to grant five virtual banking licenses will inevitably have a disruptive effect on the local financial services industry.[1] Two of the new licenses will be for the full range of retail banking services, which means that, for the first time in Singapore, non-banks will be able to accept deposits from and provide financial services to retail customers. The remaining three licenses are intended for wholesale banking.

Virtual banking—and the innovation, inclusion, and customer choice it brings—is becoming prominent around the world. Hong Kong, South Korea, the United States, and United Kingdom have already opened the door to virtual banking. And some major Singapore banks are also gaining virtual banking experience, with DBS' digibank in India, and UOB's TMRW in Thailand.

Who are the new entrants?

Virtual banking changes what we traditionally think of as a bank. And new virtual banks in Singapore might diverge in their origin. They might be foreign banks looking for a way to break into the Singapore market without the expense of building branch offices. Or they might be payment companies, insurers, or fund houses seeking to expand the range of financial services they offer. There also could be interest from giant international digital retailers or telecommunications companies.

But whatever their origin, entry of non-banking players has the potential to accelerate current momentum to integrate banking and non-banking supply chains and ecosystems.

Digital versus virtual

Most major banks around the world have gone digital to some degree. From simply checking a balance to getting cash at an ATM to managing complex payments, consumers have grown accustomed to choosing between going to the local branch or banking on their home phone, cell phone, or computer.

But virtual banks are a newer, more disruptive form of banking. Virtual banks differ from other forms of digital banking in that they only exist online. They have no branch offices within a community or a country.

Consumers expect virtual banks' savings in facilities and staff to directly translate to receiving higher interest rates on savings and paying lower rates on loans. However, some consumers might miss the emotional comfort of visiting a local branch office, renting a safety deposit box, seeking a banker's advice, or working with residents who support the local economy and local events.

The impact of virtual banks

Virtual banks could pose a significant threat to the three largest Singaporean banks. New licensees are likely to be backed by benefactors with deep pockets. They will likely have significant "beyond-banking" strategies that might be hugely disruptive.

As an example, consider what is already happening in cross-border remittances. Monzo, a UK-based virtual bank, offers users international payments without additional fees or charges. And the bank does not charge extra fees for customers to withdraw up to GBP 200 per month from international ATMs.[2]

New entrants are likely to come in unpredictable ways. To increase competitive advantage, incumbent banks will need to leverage their customer bases, resources, and reputations more than ever. They will also need to sharpen their value propositions and, with the power of artificial intelligence (AI)-enabled hyper-personalization, become even more customer-centric.

For example, AI, which is rapidly moving from experimentation to scale, can augment banks' ability to measure customer satisfaction and anticipate which clients are most likely to leave for a better offer. AI can help determine specific types of offers or "next best actions" that might help induce clients to remain loyal—or just remain.

Lessons from beyond

Impacts of virtual banking in other countries has been varied. In the US, the two leading virtual banks offer credit cards, loans, and personal savings accounts. They already hold billions of dollars in assets.[3] In the UK, virtual banks, which must follow the same rules as retail banks, started offering small business loans and savings two years ago.[4]

South Korea's two virtual banks, which fit well into the country's low-cash-use economy, lost a combined USD 78 million in 2018.[5] However, it's too early to tell if that is simply the cost of getting started. One of these banks gained 300,000 customers in a 24-hour period when it started up in mid-2017—impressive growth by any measure.[6]

One study shows the average cost of a banking security breach is USD 3.86 million.

The Hong Kong Monetary Authority has issued licenses to eight virtual banks, which are expected to begin operation within the next six-to-nine months.[7] Major Hong Kong banks are already responding by waiving or reducing loan and account fees, generating immediate customer benefits.

It's likely that Singapore will follow a similar—although not identical—model. For example, Singapore seems to be creating a strong business environment for virtual banks, but unlike some other regions, such as the UK, is not explicitly encouraging them.

Key considerations for new entrants

Given that Singapore is a small and saturated banking market, new virtual entrants will try to take market share with innovative propositions, such as the ability to get a single view of finances across multiple banks. (See case study, "Orange Bank.")

As with any bank or banking entity, the ability to address stringent regulatory, compliance, and security requirements is key to the success of new entrants. Indeed, regulation and security are perhaps the most important considerations in the development of virtual banks. Regulators must navigate a narrow route. They must avoid causing a loss of confidence as a result of perceived lax controls. At the same time, they must not impose a wall of restrictive compliance and regulatory standards on new entrants. The goal is to maintain financial stability by encouraging rapid innovation in banking.

Security is also a fundamental requirement for virtual banking. One study shows the average cost of a banking security breach is USD 3.86 million.[8] Regulators and the public-at-large will not tolerate lax security among virtual banks. Accordingly, MAS has released frameworks with detailed requirements for companies applying for either retail or wholesale bank licenses.[9]

Case study: Orange Bank

Since late 2017, Orange, a leading French telecom operator, has been operating a disruptive banking model in France with Orange Bank, reaching about 100,000 customers.[10] Orange Bank's innovative service, called Djingo, is a virtual advisor that allows customers to interact with their bank when and where they want. In France, mobile banking is becoming pervasive. Sixty-three percent of bank customers downloaded their bank's app, and 47 percent use it at least weekly.[11] And Djingo can answer questions in natural language and perform actions such as blocking or unblocking a credit card.

Djingo was designed to serve as the first point of contact with Orange Bank. About one-in-five interactions with Djingo are outside normal working hours. And when contact with a professional banker is sought or required, Djingo smoothly transfers the conversation to an expert, along with all the pertinent details already covered.

Cognitive Enterprise

Imagine the Cognitive Enterprise as composed of multiple business platforms. One or more of these acts as the core or primary platform(s), providing key differentiation. Organizations use and access secondary or supporting platforms as well. For example, middle- and back-office processes and underlying technology suites may be used to partner with other industry players or third parties.

The business platform, then, is made up of capability layers. Each is subject to major transformation, and the potential that we envision for companies and organizations is huge. We think that incumbents will—as we are increasingly seeing—strike back if they can orchestrate change at scale.[12]

Making virtual a reality

It may be that your non-bank enterprise is already considering a new foray into the world of banking. Or perhaps you are with a financial institution that needs to come to grips with new virtual banking competition. In either case, you can take steps to position for success in the race between new entrants exploiting their speed and flexibility and incumbents driving new value from relationships and data.

For potential new entrants:

– Clearly define a disruptive value proposition that will enable you to grab market share in a highly saturated banking marketplace. A new value proposition may call for forging new partnerships, supply chains, and ecosystems.

– Build, acquire, or lease the right banking technology platform. The technology decisions you make today will have long range implications. A lightweight cloud-based core system, built on a modern technology stack that can use exponential technologies, such as AI, IoT and blockchain, is an ideal choice.

– Address regulatory, compliance, and security considerations in your own operations and demand the same across your new banking ecosystem.

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For incumbent banks

- Deepen customer engagement and sharpen value propositions. Your customer data can be a competitive weapon. Leverage the power of existing relationships and data to create highly personalized customer experiences that will be challenging for new entrants to match.
- Deploy AI to augment your organization’s ability to respond quickly to changing market conditions and customer expectations.
- Become a Cognitive Enterprise by:
  - Offering clients extreme convenience
  - Extending your portfolio beyond traditional banking
  - Deploying new technologies to radically lower your cost to serve clients
  - Offering world-class security. Once trust is lost, reestablishing it is very expensive (see sidebar, “Cognitive Enterprise”).

Key questions to consider

- What plans do you have in place if a new banking model challenges your customers’ loyalty?
- Whether you work for a traditional or a virtual bank, what value proposition have you established to help you succeed against new competition?
- Where does your organization stand against the competition on deploying enabling technologies, such as AI, IoT, and cloud?

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