BANKING

***Maintain* POSITIVE**

Banking on the virtual

KEY INVESTMENT HIGHLIGHTS

- **Bank Negara Malaysia have issued the exposure draft on Licensing Framework for Digital Banks**
- **5 licenses are to be issued and in our opinion, prominent e-money providers are the front-runners**
- **Interestingly, limit is placed on total asset size and not on type of customers**
- **Digital banks will not be allowed to establish any branches**
- **High enough capital requirements to ensure that digital banks have strong backing from its shareholders**
- **Seems to be taking cue from regional monetary authority with a hybrid approach**
- **No medium term threat to existing banks, maintain our POSITIVE stance on the banking sector**

Exposure draft finally out. Bank Negara Malaysia (BNM) had finally released the much anticipated exposure draft on Licensing Framework for Digital Banks last Friday. BNM aims to finalise the Policy Document by 1HCY20. We believe the following to be the salient points:

- 5 licenses to be issued either conventional or Islamic banking business will be required to comply with the requirements of the Financial Services Act 2013 (FSA) or Islamic Financial Services Act 2013 (IFSA)
- Asset threshold of not more than RM2 billion in the initial three to five years of operations, i.e. the foundational phase
- During the foundational phase, licensed digital banks will be subjected to a more simplified regulatory requirement relating to capital adequacy, liquidity, stress testing and public disclosure requirements
- Minimum capital of RM100m during foundational phase, and RM300m thereafter. Meanwhile, minimum total capital ratio of 8% with only Common Equity Tier 1 (CET1) capital is recognised in the computation of TCR
- Potential licensee would have to submit an exit plan in the license application
- Licensed digital bank cannot have physical branches

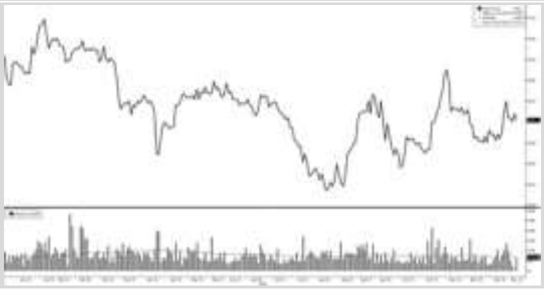
E-money providers most likely front-runners. We believe that it is only a natural progression for e-money providers to expand into the digital bank space, especially with the explosion of e-money users. After all, it means that these providers could better utilise its deposit liabilities. However, there are currently a plethora of e-money providers with 42 non-bank providers. With 5 licenses going to be issued, we believe the most likely candidate for applying for the license will be the prominent ones such as Boost, Grab, Touch 'N' Go and BigPay.

COMPANY IN FOCUS

Malayan Banking Bhd
Maintain **BUY** | Unchanged Target price: RM10.30
Price @ 27th December 2019: RM8.61

- Earnings started to improve in 3QFY19
- Low exposure to floating rate which should moderate OPR cut impact
- It has scale and size
- Attractive dividend yield of circa 6%

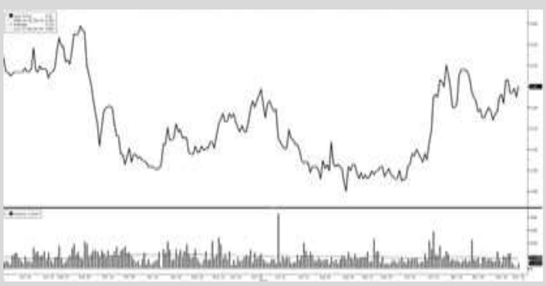
Share price chart



CIMB Group Holdings Bhd
Maintain **BUY** | Unchanged Target price: RM6.30
Price @ 27th December 2019: RM5.30

- Earning recovery in Indonesia and Thailand
- Net interest margin recovered
- Robust net income
- Relatively undemanding valuation
- Decent dividend yield of circa 5%

Share price chart



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Proliferation of e-money. The growth in e-money usage have been tremendous recently. Volume and value of transactions for year-to-date Oct'19 grew +8.0%yoy to 1.59b and +57.8%yoy to RM13.9b respectively. E-money users (including users with multiple e-wallets) have grown +56.8%yoy to 89.9m as at Oct'19 with card based e-money users expanding +12.5%yoy to 42.7m. Most astonishingly network based e-money users have exploded with a growth of +144.4%yoy to 47.1m as at Oct'19.

High enough capital requirements. We opine that the capital requirements are high enough to exclude either start up or smaller fintech companies and e-money providers. This mean companies with strong shareholders are the most likely to apply for the license once the framework is finalised. We noted that the minimum capital of RM100m during the foundational phase is lower than any current requirements but the RM300m thereafter is similar to the requirement for a locally incorporated foreign bank. Meanwhile the minimum total capital ratio requirement is the same as with existing traditional banks.

No branches network is a requirement. In our view, it is interesting that digital banks are not allowed to establish any physical branch. A licensed digital bank is required to establish a registered office in Malaysia but this is to facilitate communication with BNM or face-to-face customer complaints. We understand that some countries allows for digital banks to have one branch. However, we speculate that this is to push the digital banks to offer its products through digital innovation. With this requirement, we expect that this might disincentivise existing traditional banks to acquire the digital bank license. It would mean that existing banks will have to create a digital bank subsidiary and with that, it could tie the banks with additional capital. Besides, existing banks' licenses already allowed it to offer its products digitally. However, we understand that **CIMB (BUY, TP: RM6.30), Affin (NEUTRAL. TP: RM2.10), Hong Leong Bank (NEUTRAL, TP: RM17.70), AMMB (TRADING BUY, TP: RM4.20)** and Standard Chartered have expressed interest. Of these, CIMB is the only one with experience after it had set up a digital-only bank in Philippines and Vietnam

Limitation is on asset size not type of customers. Another point that we found interesting was the asset size limitation. We had expected the limit will be applied on the type of customers such as retail and SMEs only. Also, we had expected there would be restriction on a per customer basis. Nevertheless, we believe that the RM2b total asset is an implicit limit. We opine that this will steer the digital banks towards more micro lending offerings.

Seems to be taking a hybrid approach. We opine that BNM seems to have taken a hybrid approach between the requirements issued by the Monetary Authority of Singapore (MAS) and Hong Kong Monetary Authority (HKMA). Recall, the MAS have made a distinction on the type of digital banks it will issue a license to: 2 digital full bank (DFB) licences and 3 digital wholesale bank (DWB) licenses. For DFB, MAS will cap the amount of deposits allowed, and will also be barred from offering complex investment products, like structured notes, derivatives, and proprietary trading. While for DWB, it cannot take deposits from individuals (except for fixed deposits of at least SGD250,000) but free to open and maintain business deposit accounts for SMEs and other businesses. As for HKMA, it has stressed that ownership is important given the higher risks during the initial years of operations. Hence, HKMA has indicated that parent companies of a virtual bank must be committed as well as be capable, to provide strong financial, technology and other support to the virtual bank when necessary.

Shielding the banking system and driving the financial inclusion agenda. In our opinion, the purpose of the initial draft requirements set forth by BNM are two-fold; (1) minimize the exposure of the financial system to the new method of banking with asset size limitation and capital requirements, (2) drive its financial inclusion agenda especially with the limit to asset size.

Not a threat in the medium term hence we maintain POSITIVE. Overall, we believe that it is still early days for digital banks to be a threat to existing banks in the short to medium term. We believe that it is most likely that the digital bank licenses will be issued by end CY20 and operational by CY21. In addition, the type of banking products have been implicitly limited during the foundational years and banks are already investing heavily to enhance its digital offerings. Therefore, we maintain POSITIVE on banks at current juncture with **Maybank (BUY, TP: RM10.30), CIMB** and **RHB (BUY, TP: RM6.35)** as out top picks.

PEER COMPARISON TABLE

	FYE	Rec.	Price @ 27/12/19	Target Price	EPS (sen)		PER		Net DPS		Net Div Yield		BV		PBV	
					19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21	19/20	20/21
Maybank	Dec	BUY	8.61	10.30	74.1	73.9	11.6	11.7	58.0	58.0	6.7	6.7	7.1	7.4	1.2	1.2
Public Bank	Dec	BUY	19.88	24.00	145.6	148.7	13.7	13.4	72.0	73.0	3.6	3.7	11.3	12.0	1.8	1.7
CIMB	Dec	BUY	5.30	6.30	50.0	49.0	10.6	10.8	26.0	26.0	4.9	4.9	5.6	5.7	1.0	0.9
RHB Bank	Dec	BUY	5.84	6.35	62.4	67.7	9.4	8.6	25.0	27.0	4.3	4.6	6.3	6.5	0.9	0.9
Hong Leong	Jun	NEUTRAL	17.60	17.70	130.0	143.1	13.5	12.3	50.0	50.0	2.8	2.8	12.5	13.0	1.4	1.4
AMMB	Mar	T. BUY	3.96	4.20	50.0	46.6	7.9	8.5	20.0	20.0	5.1	5.1	5.9	6.1	0.7	0.7
Affin	Dec	NEUTRAL	1.91	2.10	29.0	29.0	6.6	6.6	5.0	7.0	2.6	3.7	4.7	4.7	0.4	0.4
Alliance	Mar	T. BUY	2.61	3.35	34.7	32.6	7.5	8.0	16.7	14.5	6.4	5.6	3.7	3.7	0.7	0.7
BIMB	Dec	BUY	4.45	5.05	43.7	44.0	10.2	10.1	16.0	18.0	3.6	4.0	3.2	3.5	1.4	1.3
Average					**68.8**	**70.5**	**10.1**	**10.0**	**32.1**	**32.6**	**4.4**	**4.6**	**6.7**	**7.0**	**1.0**	**1.0**

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.