5 Neobanks: creating a digital bank from scratch

Making banking licences easier to obtain paves the way for new players

Among the *FinTech* firms, some aspire to become banks and to provide a purely digital alternative to traditional institutions. Up to now, the biggest stumbling block they had run up against had been the complexity and cost when it came to obtaining a banking licence, but in the UK steps have already been taken to simplify this process, which has spawned several "neobanks".

Introduction

A feature of the emerging companies within the financial sector (*FinTechs*) is that they specialise in a single product, where their greater flexibility and a better customer experience, as well as the lighter regulatory shackles, affords them a competitive advantage compared to the traditional banks. The segments of the banking value chain where most of these have sprung into being are in payments, and more recently lending to individuals and small businesses.

A major group among those companies which seek to become protagonists in the financial lives of people or their reference bank are the so-called "neobanks". These banks aspire to meet the financial needs of a very large portion of the population who have no need for sophisticated products. They basically use digital channels, especially or exclusively mobiles, and above all target customers from among the younger generations who are more willing to accept a bank with no physical presence.

The range of products they offer is based on current and savings accounts, debit and pre-paid cards, basic services such as wiring money peer-to-peer, combined with various different financial management tools (help with savings schemes, and handling expenses and payments via alerts and messages etc.). Yet what makes them original is their focus on a better, more user-friendly experience, via mobile phones and other virtual channels, as well as their emphasis on transparency and bringing down commissions and fees. Using this approach they seek to build up customer loyalty and obtain data and feedback that can enable them to improve their services by tailoring them to consumers' needs.

So far, the volume that such banks command in terms of customer numbers is small and what they offer is founded on basic services, mainly current and savings accounts. Nonetheless, their needs-oriented approach to customers, especially millennials, and their originality makes them worth consideration as potential competitors for the established banks.

Compared to the traditional banks, they have the advantage of not having a complex legacy technology burden, with data that is hard to exploit through being organised into silos, and the cost-saving that comes from not having a physical distribution network. Such modernity and simple technology systems, as well as non-reliance on a physical network, make them very well-placed to grow rapidly in new markets. Furthermore, right from the start they have attached importance to customer data which will allow them to tailor their products to customer needs and offer keener prices. Agility and efficiency of this type, as well as greater familiarity with the needs of digital customers, are what gives them the edge in competing with the traditional banks.

Two approaches: relationship-only and full service

Although they all describe themselves as banks, two broad groups are discernible. On the one hand, there are the companies that have no banking licence and only offer the customer a relationship-side service, either using a traditional bank for processing transactions or in a partnership model. In such a case, compliance with the regulations is ensured by the bank on which they base themselves. Such companies focus the value they can offer on a better user experience, and place emphasis on tools to help out with financial management (PFM), such as Mint, which evolve by boosting transaction management services. Examples of this are: Simple, Moven and GoBank in the United States or Number26 in Europe.

With the abundance of firms which offer financial services, building a bank by bundling up various services via APIs becomes feasible, where the way in which these are processed, or the bank through which they are supported, is transparent for the end user.

We also come across a development in terms of pre-paid cards, whereby basic current account services can be provided without the usual regulatory requirements. This is, for example, the case of Bluebird, which is a product launched by Walmart and American Express to target relatively unbanked population segments in the United States, and which enables payments to be effected both into and out of the account.

On the other hand, the second model involves those who seek to become all-in, one-stop-shop banks from the outset, but without branch-based distribution channels and set up as mobile banks. These include examples such as Fidor, a German bank founded in 2009, which is notable as an innovator and has been operating in the UK since 2015, or mBank in Poland.

To operate as banks, while not using the model as in the case of the first group to ensure consumer protection, banks of this kind must obtain banking licences, which in most countries is a complex process and financially costly.

To incentivise competition, the financial authorities in the UK (FCA and PRA) have changed the conditions for obtaining banking licences by lowering the capital requirements, extending the window for acquiring the capital necessary under Basel III and simplifying the process for obtaining a licence, which has made it possible to shorten the time for such processing from over two years (which is how long it took Metro Bank to obtain its licence as the first new bank to do so in 100 years) to six months under the new scenario. The new process for obtaining a licence consists of three phases[2]:

- An initial application, where the official form and the business plan are submitted to a committee.
- Application: this is submitted after the first phase has been satisfied
- Licence start-up: capital build-up period

From the publication of these rules until December, over 20 UK applications had been received and licences were given to Atom Bank in June 2015 and to Tandem Bank in December.

Atom Bank was founded by Anthony Thompson, co-founder of Metro Bank, and investors in it include BBVA (with a 29.5% interest), Anthemis Group, Woodford Investment Management, Polar Capital Group and Marathon Asset Management.

Tandem Bank, formerly known as OpenBank, was founded by, among others, Matt Cooper, who was previously with Capital One, and Ricky Knox, founder of Azimo. Investors in it include Route 66 Ventures.

We will have to wait to see whether other countries take up the lead of Britain's regulators and also simplify their procedures for obtaining authorisation to facilitate the entry of new banks.

The traditional players are also looking into the options for distribution models via purely digital channels, examples of these being Hello Bank (a subsidiary of BNP Paribas) or UBank (of Australian bank NAB). In these cases, the range of products on offer could be broader and take in more complex products such as mortgages, as they have the backing of their parent banks.

2: *Banking authorisation process*, Financial Conduct Authority, London, 2014 <https://www.fca.org.uk/static/documents/banking-authorisation-process.pdf>

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