



NEOBANKS – EVOLUTION OR REVOLUTION IN THE FINANCIAL SERVICES INDUSTRY?

AN ECONOMIST’S PERSPECTIVE

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- Office of the Comptroller of the Currency – AML, mortgage underwriting and pricing, credit card models
- University of Arizona (tenured); PPIC (Research Fellow); EY (transfer pricing)

Primer on The Economics of Money

Money

- Fundamental Properties: Store of Value, Medium of Exchange, Unit of Account
 - 3000 BC: line of credit in Babylon (interest rate, date, repayment amount)
- Form: Fiat (money-as-a-shared-story), non-Fiat (gold, oil, wheat, shells, cigarettes,...)
- Purpose: Utilitarian (improves *efficiency of economic activity*) & Amplifier (*more economic activity*)
 - Seigniorage, FX; Politics/Power (Isaac Newton vs. Louis XIV)
 - Intertemporal nature of money (lending and borrowing is possible)
- Management: Monetary Supply, Govt debt default
 - Stability is essential to minimize uncertainty and generate trust

Primer on The Economics of Banking

Banks Are Not Like Other Firms

- Banks are matchmakers, akin to platforms, between lenders and borrowers
 - Serve depositors and lenders, manage stockholders and regulators and authorities
 - Their business is to transfer money between accounts in the same or another bank
 - Accounts are the “cells” which contain the value defined by the monetary units it comprises
 - An account is funded with a deposit of cash or its equivalent and recorded
- Economies of Scope enable banks to manage uncertainty of profits stemming from temporal, risk, elasticity of demand, consumer and product life cycles
 - E.g. lower profit deposit accounts are subsidized by higher risk, higher-priced mortgages

Economics of Banking

Essential characteristics

- Trust and relationships – short- and long-term
- Product is consumed over time and paid in increments
- Pricing is based on risk, imperfect information and macroeconomic external
 - Real vs nominal prices
- Role of central government and regulator
 - Compliance
 - Government backing: Insurance, “Too Big to Fail,” licenses protect market/monopoly power
 - Systematically Important

Current Debates Around Money & Banking

Digital or Analogue (Cash is King?)

- Economic Forces & Competition
 - Central Bank competition – US\$ is global currency Fed has domestic mandate
 - “Synthetic Hegemonic Currency” by the IMF (BoE Gov Mark Carney)
 - Traditional FIs compete with one another and new entrants (FinTechs, Noebanks, CBs)
- Innovation & International Commerce
 - Mobile phones, digital ledgers, blockchains
 - Open Banking, PSD2, Durbin Amendment (UK, US, EU, ...)
 - Settlement is still a hurdle (*Regulated Liability Network*)
 - Do borders matter?? – Compliance, national sovereignty
- Other Shocks
 - COVID & Geopolitical uncertainty (Russia, China, Middle East, UK, EU, US, South America)

Neobanks, Digital Banks, Challenger Banks

What's a Neobank?

- Easy part: Digital/Online only; UX and convenience; lower pricing, quick decisioning
 - Rely on non-traditional data for risk assessment, underwriting, pricing decisions
- “Neobanks offer novel services and leverage technologies that may make them attractive to particular consumer groups. Banks enable the services neobanks provide, either via BaaS platforms or direct-to-bank integration. However, some neobanks are also pursuing bank charters.” Bradford, Terri (2020), “Neobanks: Banks by Any Other Name?” FRB of Kansas City
- The UK’s Financial Conduct Authority (FCA) calls neobanks “Digital Challengers”
- What they are not (mostly): “bank,” “challenger bank”

Primer On Neobanks

Evolution or Revolution?

- Neobanks are *bank-adjacent* in most cases
- Neobanks by virtue of being digital-only need to differentiate themselves
 - Are they regulated (**chartered**)?
 - Varo is the first bank chartered by OCC and insured by FDIC
 - Do they offer financial services such as deposits and lending, wealth management, currency exchange?
- Neobank relies on relationships with FinTechs and chartered banks
 - Neobanks sit between FinTechs and chartered banks to provide financial services
 - Approximately 250-400 neobanks & 150 million users globally (depending on sources)

Segments Served by Neobanks – Illustrative Examples

Kids & Teens	
Anna Money	UK
Anytime	France
Aoin	Belgium
Arival	US
Aspire	Singapore
Axos Bank	US
Blank	France
Brex	US
Bunq	Netherlands
Coconut	UK

Personal	
Copper	US
GoHenry	UK
Greenlight	US
Kard	France
Monzo	UK
Mydoh	Canada
Nimbl	UK
Osper	UK
Pixpay	France
Revolut	UK

SMBs, Businesses	
Bunq	Netherlands
Kroo	UK
Atom Bank	UK
Currensea	UK
Fineco Bank	Italy
Bank Mobile	US
Atmos	US
FairFX	UK
CurrencyFair	Ireland
Carte Zero	Luxembourg

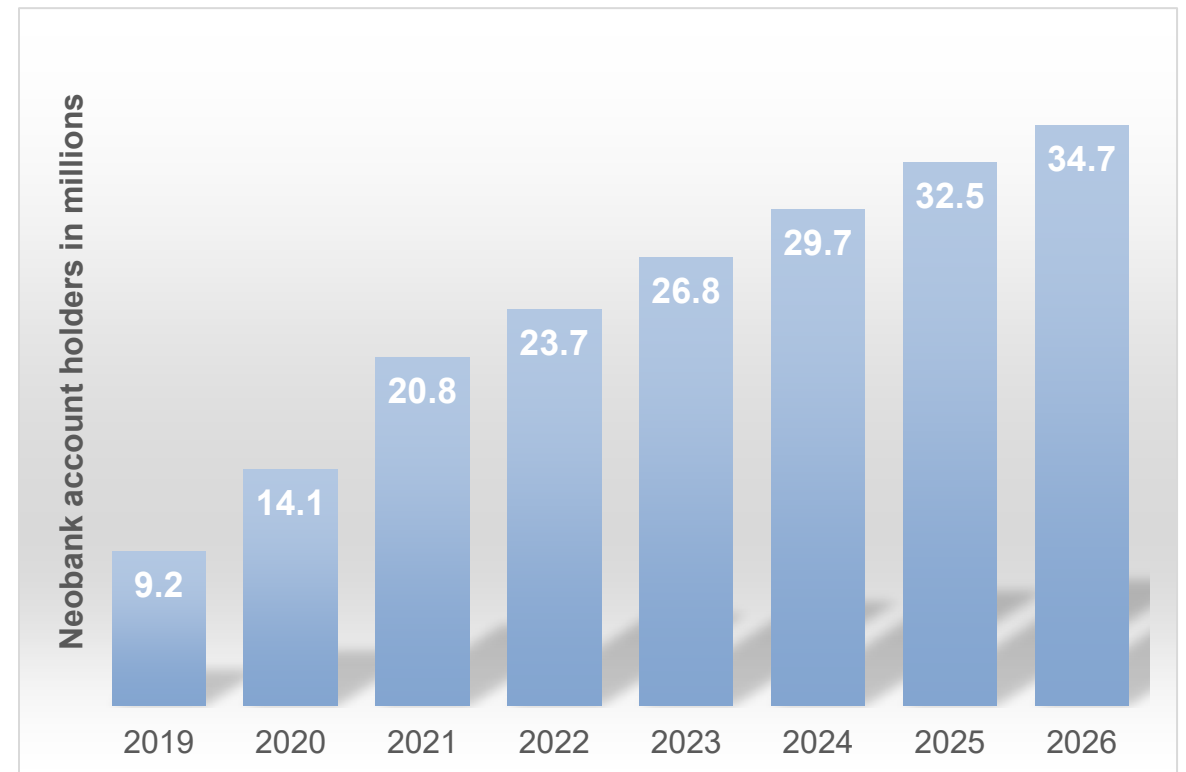
Select Statistics on Neobanks

Definitive data are hard to come by

- Neobank-related transaction value of will reach \$2.60 trillion by 2027
- Global adoption rate will rise from 15.5% to 22.8% from 2023-2028
- Brazil 43%; India 26%; Ireland 22%; 17-21% (MX, UAE, HK, SG)

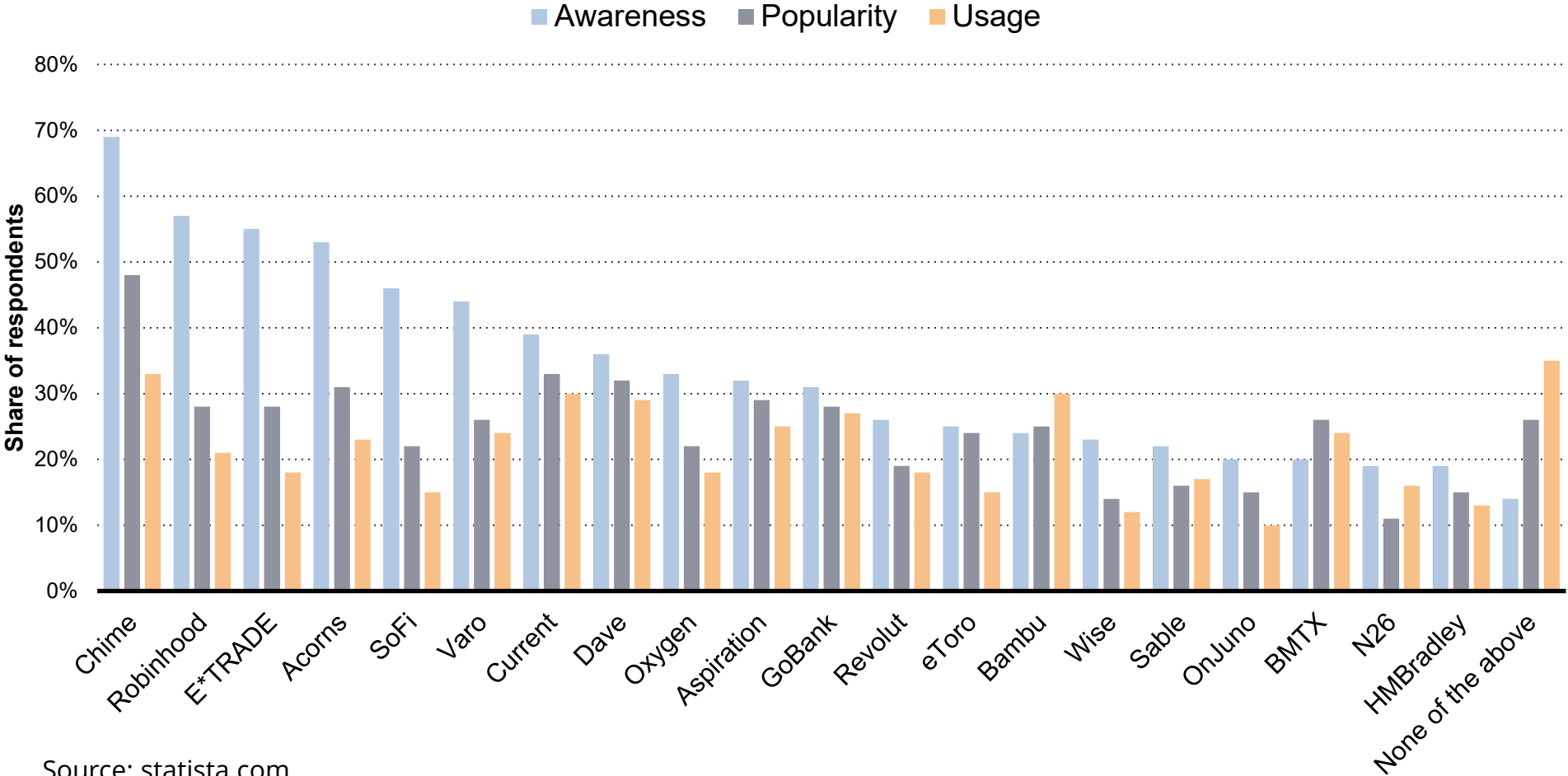
Source: www.seon.io

Holders of a Neobank Account in US, 2019 – 2022 & Forecast 2023-2026



Source: statista.com

Neobanking and Neobrokerage popularity in the US, 2022



Source: statista.com

Neobanks Primer, cont.

Where do neobanks fit into the FS industry?

- Some Banks set up their own neobanks, compete on products, or work directly with neobanks
- Functions
 - KYC, Compliance
 - Wallet (account-based) offered through Venmo
 - Settlement?
- Tend to offer non-complex financial products (BaaS) aimed at specific customer segment
- Value proposition & comparative advantage
 - Agile and nimble business models; Identify risk better
 - Offer products not offered by traditional FIs
 - Piggy-back off FinTechs and banks through formal relationships

Business Model of Neobanks

- Success is predicated on
 - Technological superiority
 - UX design, ubiquity of access, Customer service
 - Market demand and regulatory environment (PSD2)
 - Lower costs related to branches and physical delivery of banking services
 - Compliance – Wage bill would be expected to be similar for comparable traditional banks

 - Each customer must be acquired, served, retained, and successfully marketed more products
 - Beside product, need to focus on Reputation and Trust

 - Comparative advantage
 - Agile & quick to act to market conditions, convenience, lower prices, better customer UX
 - Specialize in specific segments of consumers and financial products: SMBs, underserved, wealth/savings management, Venture capital

Traditional Banks Response to Neobanks

At least four responses

- Start subsidiaries to directly compete with startups
 - Product and services aimed at market segments
 - Establish relationship with neobank and FinTechs
 - No response
-
- Smaller economy of scale leads to focus on specific customer base or select financial products
 - Chase margins: go after Retail (individuals, SMBs) or Wholesale customers
-
- Market segments, financial products, time, economic conditions, regulation, and competition

Issues to Consider

Competition, Innovation & Regulation & Compliance

- Always changing regulatory landscape: PSD2 -> PSD3 in EU; OpenBanking in the US and UK
- Compliance & Regulatory costs may increase
- Incumbent FIs may catch up, acquire, or outlast neobanks
- Smaller economy of scale and scope limits opportunities for neobanks
 - Are neobanks chasing always low margins segments?
 - What are the plans to achieve Economies of Scope?
- Consumer preferences will change
 - They may intent to eventually “graduate” to incumbent banks



Thank you!



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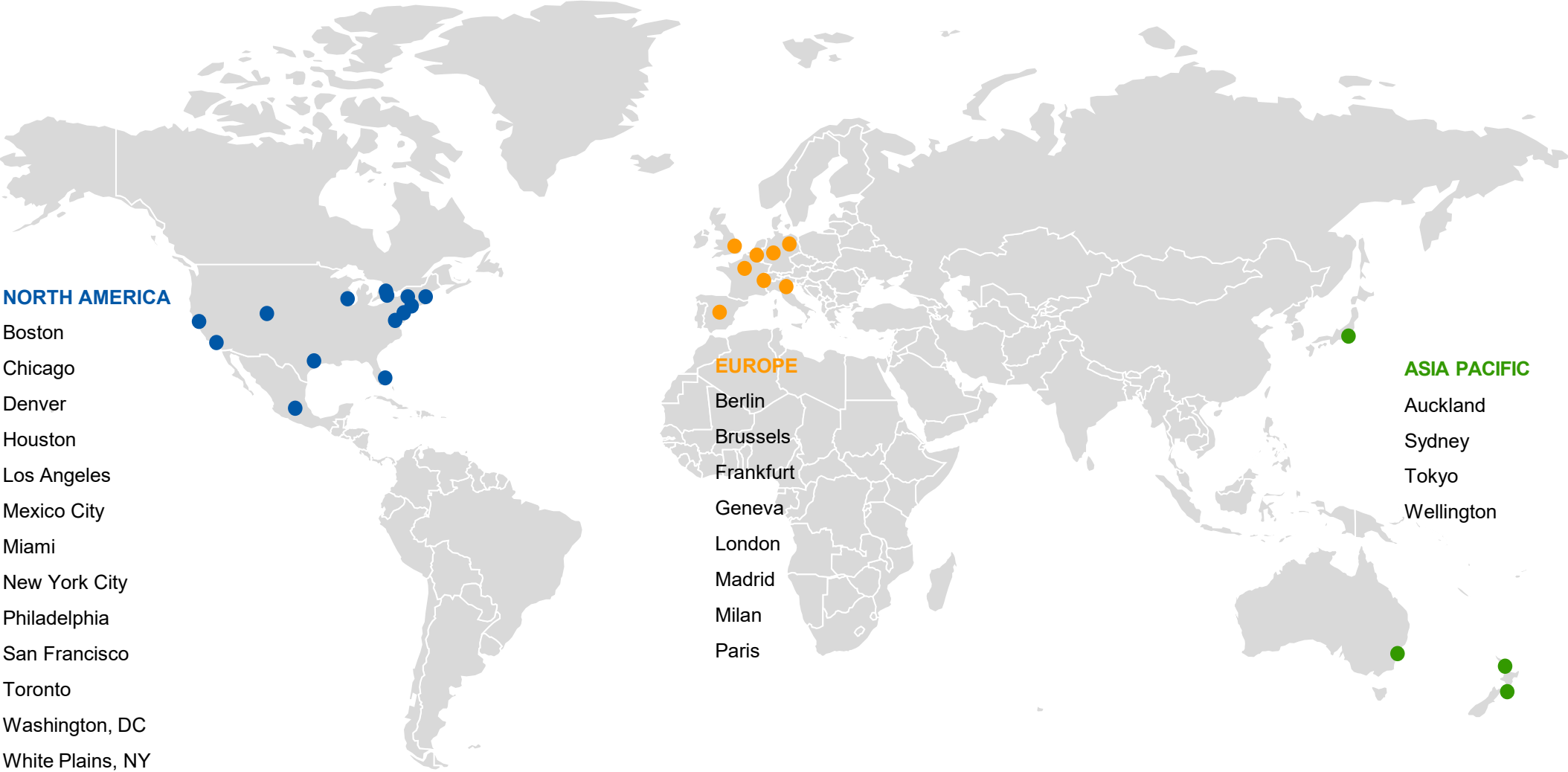
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