

The rise of the neo-bank

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Given the continued reputational damage suffered by the big four Australian banks throughout and post the Banking Royal Commission hearings, bank customers and investors may be looking for alternatives. Whilst still in its infancy, Australia's banking and credit start-up sector has grown leaps and bounds in recent years, with Afterpay Touch Group (ASX: APT) and Zip Co Limited (ASX: ZIP) being high-profile examples.

Although the "buy-now, pay-later" (BNPL) sector has received most of the media coverage, the development of so-called "neo-banks" has also started to gain momentum. Neo-banks are best described as traditional banks without a bricks and mortar presence, with their entire offering supplied through digital means, usually through an app and on-line platform. They are fully functioning deposit-taking institutions and therefore fall under the supervision of the Australian Prudential Regulation Authority (APRA). APRA must provide a license before an institution may accept customer deposits.

An unrestricted banking license permits a corporation to operate as a "banking business" and therefore an authorized deposit-taking institution (ADI) without restrictions under the Banking Act 1959. Part 5 of the Banking Act defines "banking business" as consisting of both taking deposits (other than as part-payment for identified goods and services) and making advances of money, as well as other financial activities prescribed by regulations made under the Banking Act.

The arrival of neo-banking in Australia follows the emergence of start-up banks like Monzo and Starling in the UK. Starling CEO Anne Boden told an industry conference in August 2019 that with 770,000 customers and almost £1 billion in deposits, the bank was almost profitable.

The main players in Australia (listed and unlisted) across the neo-bank sector are Volt Bank, Judo Bank, Up Bank and Xinja.

Neo-banks are defined by their lack of branches, legacy systems or physical infrastructure. They have the potential to provide ease of use, convenience and possess an untarnished reputation. DBM Consultants found that while awareness is low, consideration is high. One in three Australians are aware of neo-banks and are likely to bank with them in the future.

Australia's big four banks have considered launching their own digital bank offerings but only NAB's UBank currently exists. However, the threat to the big four banks is minimal. They have the advantage of a lower cost of funds and are investing significant amounts in upgrading their mainstream digital offerings and also, to an extent, rebuilding customer trust.

While neo-banks do not have the financial resources or customer base to overthrow traditional banking overnight, they can efficiently launch features and develop partnerships that consumers require. However, there is one technology company that has the potential to disrupt the traditional banks and that company is Amazon.

At present, Amazon offers a wide range of financial products such as Amazon Cash, Amazon Pay, loans to small and medium businesses and, shortly, a co-branded credit card with JP Morgan Chase & Co. There are murmurs that Amazon is in talks with big banks about creating a bank account for its millions of customers to use with the objective of making it easier for their customers to pay for their products from their Amazon bank account. Watch this space!!!!