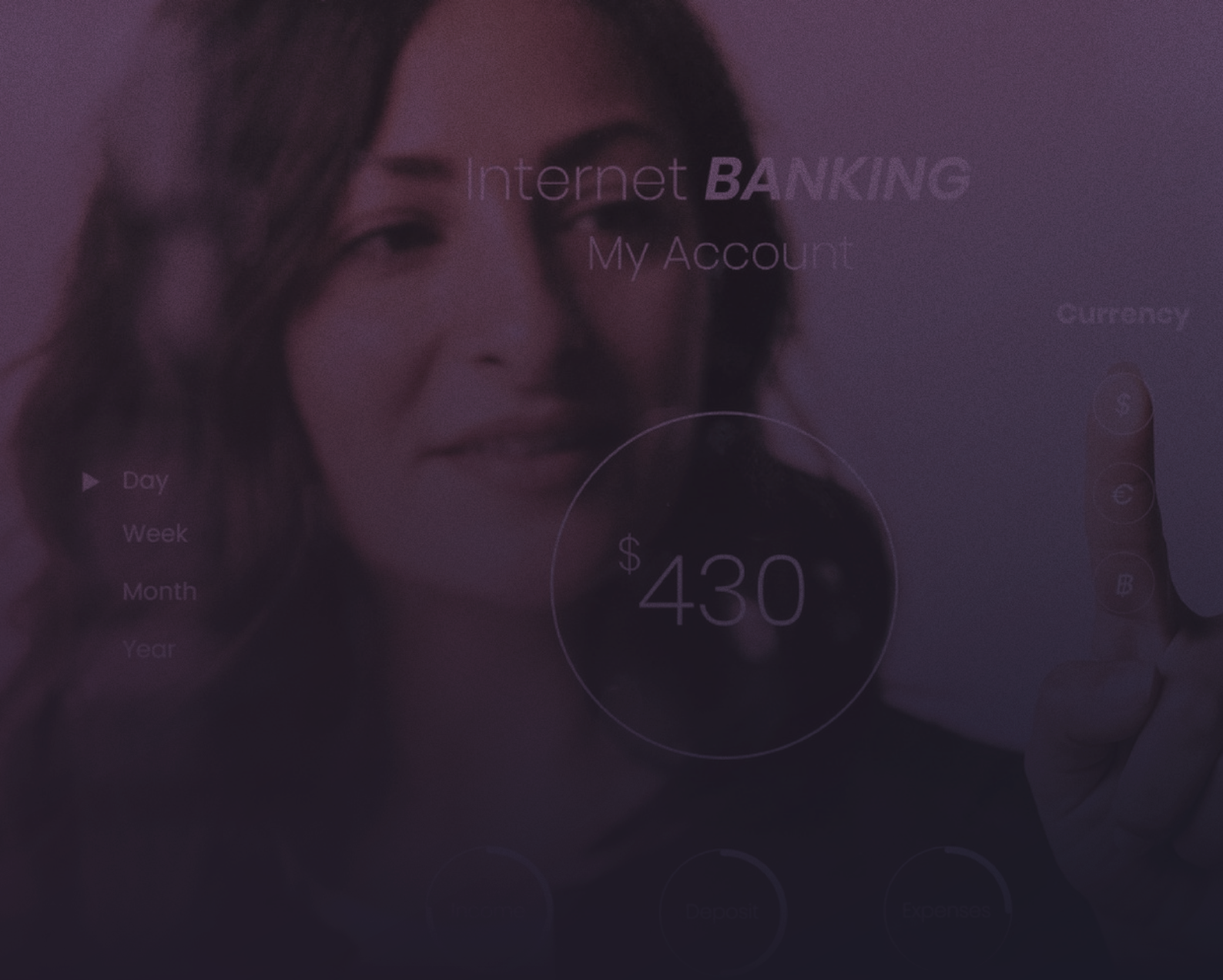

WHITE PAPER

How to Build a Digital Challenger Bank

CODEBASE TECHNOLOGIES | Demystifying Digital Financial Services

Introduction

Fintech as a vertical "has created an equal relationship where almost anyone of any age can launch a financial service system", in the words of the industry advisor Chris Skinner. As true as it may be, it is equally relevant to acknowledge a key aspect from the start: behind successful fintech stories, there is always hard work and consistency shown by fintech players that manage to fill the gaps left by their legacy competitors.

Digital challenger banks are perhaps one of the most significant examples to illustrate the point above. Against the backdrop of open banking regulations, the impact of new technologies and a dire industry need to disrupt traditional banking, recent years have brought digital start-ups unprecedented opportunities, thus fostering strong investor and customer interest in such players. While traditionally long-standing banking institutions have dominated the infrastructure, hardware and operating systems for financial services, new entrants have the agile cloud infrastructure, innovative propositions and popular features (multicurrency accounts, predictive analytics, even the ability to trade cryptocurrency), which could potentially boost customer loyalty. Many of these companies are launching new products and services via API integrations with other partners, as part of their approach to achieve scalability and conquer new markets.

The trend initially emerged in Europe, where names such as Revolut, N26, Atom Bank, Starling Bank and Monzo still stand out, but gradually gained traction across all geographies. Emerging markets including Africa (FairMoney, TymeBank), Asia (MyBank, WeBank, BigPay, KakaoBank) and Latin America (NuBank, digio, Banco Original) soon followed suit, presenting a huge opportunity for challenger banks due to large unbanked populations, high mobile penetration and growing middle classes. By taking a mobile-first approach and prioritizing simplicity and accessibility, this wave of neo-banks truly captured the attention of consumers globally, with digital-only offerings that support the local and cross-border needs of citizens. According to a KPMG report, there are currently more than 100 challenger banks everywhere around the world, from South America to continental Europe to Asia.

What are **challenger** or **neo-banks?**

The term is generally used to indicate digital-first banks that own a banking licence, with no or some brick-and-mortar locations, who conduct their business in the cloud and via mobile apps. These 'quick to market' players enable consumers to easily open a bank account, manage their finances and provide a range of features including fast payments, transaction notifications, budgeting tools, multi-currency support and the ability to open an account via an app.

Neo-banks are far more transparent and alert to charges, ensuring customers are aware of any issues or potential exposures. In terms of customer data, while big banks still struggle with a lack of predictive analytics or machine learning tools, with data scattered across multiple silo-structured systems, fintech start-ups are clearly focused on exploiting precisely this weakness.

Neo-banks are strategically targeting the younger digital-native and more digitally savvy demographic, as well as the unbanked population. A 2019 consumer behavior survey released by Marqeta shows that 49% of millennial respondents would consider switching their accounts to a digital-only institution.

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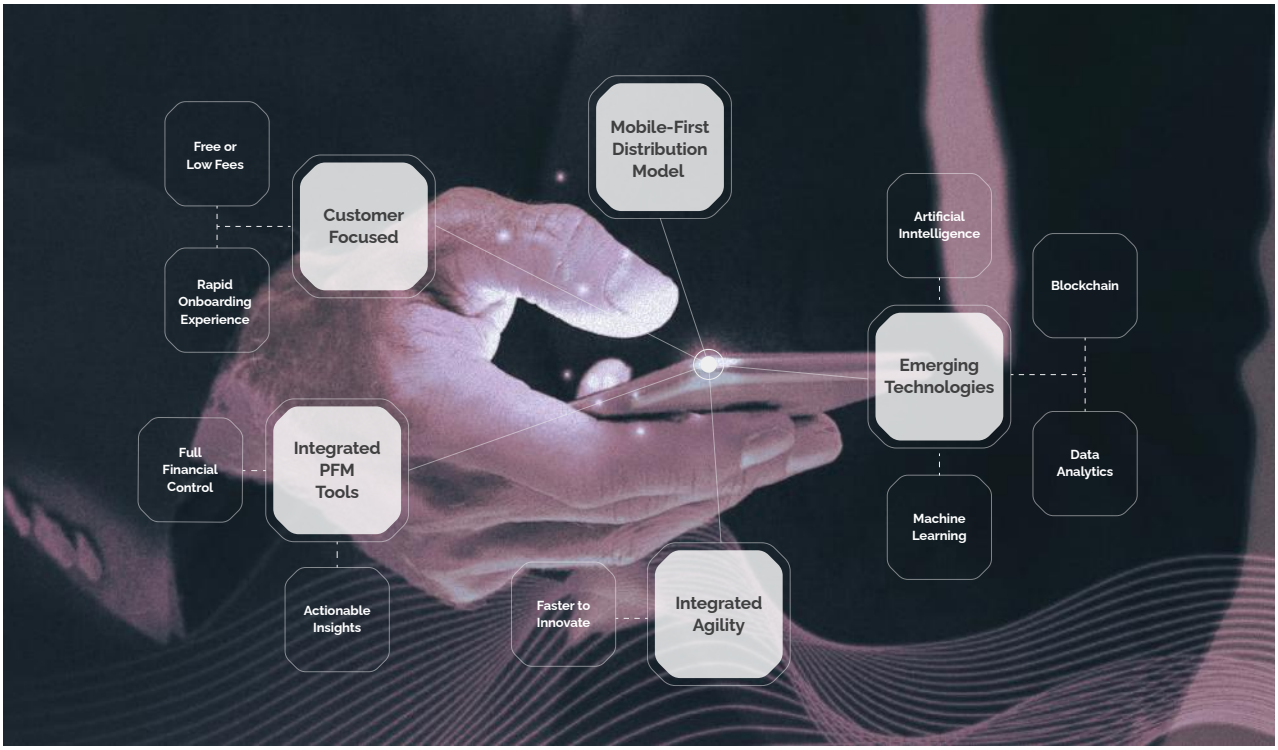


Now that the context has been defined, we will touch upon the essential aspects one needs to consider when creating a digital bank.

Defining the **business model, key features** and **services**

There is no universal formula for success that can cover the entire business models spectrum. Neo-banks typically tend to focus on a specific customer segment or product, areas usually underserved or overpriced by incumbent players. Revolut, for example, serves frequent travelers or those working overseas, US-based Deserve targets Millennials and Gen Z clients, Starling Bank positions itself as the best UK digital bank for small businesses.

Irrespective of the customer type that is served, the standard offering or the business concept that works in today's market should include most of the basic features and tools below:

- Full 100% online and remote onboarding process and account creation – including intuitive navigation, the capture of all documents, proof of identity, and signature verification
- Basic current account or wallet
- Debit card and the ability to freeze/unfreeze cards
- Payment feature (SEPA, Peer-to-Peer, FX transactions)
- The transactions history and photo bill payments
- Real-time data analytics
- Compliance software to track potential risks (money laundering, illegal money transfers etc.)
- Customer support teams and tools such as an ERP or CRM software for optimal channel management and customer enquiries
- On the operational front, a team of payment specialists who streamline payment processes and handling, reconciliation and payment tracking

While the list above highlights only the basic requirements to run a digital bank business, these will undoubtedly form the backbone of the value proposition model and underpin the strategy for future growth.

Most often than not, digital banks will pride themselves on offering their services almost free of charge. However, exploring the key business models of leading players reveals different approaches to the challenge of profitability:

The Transaction Fee Model, whereby the bank revenue is derived from the small fees received whenever a customer uses the debit card;

The Premium Subscription Model which prompts customers to pay for premium services, including insurance, unlimited free transfers and withdrawals, faster payment settlement or concierge services. Revolut was among the first players to adopt this revenue stream;

The Marketplace Banking Model which implies the creation of an ecosystem of aggregated products and services sharing similar characteristics presented to a customer as a set of offers. UK-based Starling Bank took this approach by choosing not to develop a full suite of banking services in-house, but rather inviting third parties to integrate with its Marketplace. There are nearly 11 different service provider partners within the ecosystem, offering a range of banking-related services for both personal and business account holders. By taking advantage of open banking APIs, Starling has been able to concentrate its efforts on its core products, while still offering customers access to the full range of services they have come to expect from a traditional retail bank.

As the costs of services do not significantly differ from one provider to another, it is often the customer experience that plays the biggest role in determining which provider to select.

Addressing **regulatory aspects**

In order to legally operate as financial institutions, digital banks must get the appropriate licenses and study the laws pertaining to banking and digital solutions in their respective country or region. Here are some examples below, with each license serving different purposes, activities and business models.

The banking license enables players to become a fully licensed bank, allowing them to provide not only the services customers usually expect from a bank, but also more advanced activities like granting loans or mortgages. In order to get this license, one will have to meet a range of compliance, security and data protection prerequisites.

The E-money license (EMI or electronic money institution license) is faster and easier to obtain, as compared to a standard banking license. In 2011, regulators made it easier for newcomers who could not afford the costs of a full banking charter to launch new banking-like services. With only this type of license or similar, companies are restricted when it comes to the series of payments and banking services they can provide (generally, these payment services include money transfer and currency exchange).

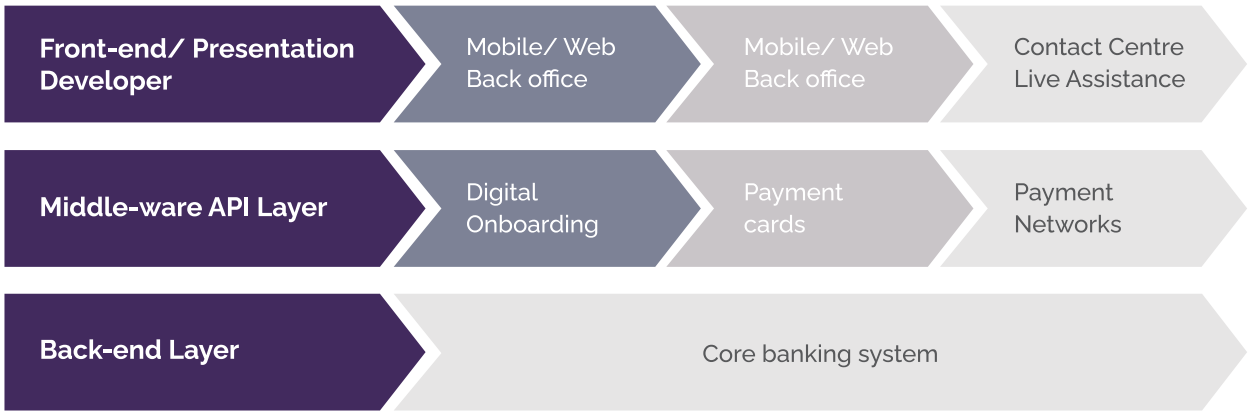
In some cases, existing traditional banks prefer to launch digital-only subsidiaries, with a distinct brand. These divisions will offer services through the parent company's license. Italy's Unicredit and its mobile-only buddybank, JPMorgan Chase and its digital-only challenger bank Finn are just a few examples.

The Agency Banking approach enables non-regulated companies to rely on the license of a third-party, like Fidor or Wirecard (under an agent or a license-as-a-service model). An agency bank is an organization that acts in some capacity on behalf of another bank. Thus, it cannot accept deposits or extend loans in its own name.

Lately, government regulators have adopted a more agile attitude when it comes to licensing digital banks. As part of their initiative to inject competition into the banking sector, the Monetary Authority of Singapore announced in 2019 that it would issue up to five digital banking licenses to successful bidders.

On a similar note, Malaysia's central bank announced plans to issue licenses to new online banks "offering either conventional or Islamic banking under a licensing framework". In December 2019, Grab, Razer and Axiata were among the companies who revealed plans to apply for digital banking licenses in the country.

Building the platform



Once the regulatory requirements have been addressed, the next step is to assemble the three layers of the new bank`s digital banking platform: the front-end (that consumers see), the back-end (the product layer which integrates the core banking system, clients data and other back-offices related processes) and the middle-ware (an intermediary layer orchestrating information between the interface, the product layer and the API layer).

Demystifying digital financial services: where do you stand?

Everywhere, customers of banks – be they consumers, merchants, businesses or other banks – are calling for better digital transformation: for faster, more convenient and more innovative digital services.

Mastering the digital transformation that this context brings, while facing all opportunities and related risks, is the key for success and Codebase Technologies understands this prowess. We have more than 20 years of experience in supporting businesses to unlock the true potential of the digital financial ecosystem and address their need for innovation.

Instead of creating each service in-house or integrating with third party providers, it is possible to take advantage of a complete digital banking infrastructure, which includes Digibanc, our state-of-the-art multi-channel, white-label digital banking platform. Digibanc, a comprehensive one-stop 'Bank in box', combines functionalities from traditional core banking systems and new fintech capabilities into a unified digital customer experience. Enhanced capabilities include customer onboarding, eKYC, complete core banking modules and payment services.

As a global leader in financial services and banking technology, we help organizations create and deliver innovative and intuitive experiences across customer lifecycle. Our solutions give an innovative rise to new opportunities for enterprises looking to disrupt the existing norms and act as a catalyst to deliver practical and successful digital transformation agendas.

About Codebase Technologies

Codebase Technologies (CBT) is a Global Open API Banking solutions provider that enables banks and financial institutions (both Conventional and Islamic) as well as the emerging FinTech ecosystem to Demystify Digital Financial Services. We help organizations create and deliver Innovative and Intuitive experiences across the customer lifecycle.

With presence and customers across 4 continents, Codebase Technologies with its award-winning suite of products, including the innovative Digibanc™, a comprehensive one-stop 'Bank in box', helps its customers unlock the true potential of the next generation of the digital financial eco-system.

Get in touch with our digital banking specialists today to help you accelerate your digital banking journey.

Visit us at **www.codebtech.com** or get in touch at **marketing@codebtech.com**.

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