

Fintech And Innovation Neobank

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1. Neobank overview:

Ordinary banking traditions may bring to people's minds homogeneous brick-and-mortars, ATMs machines and much paperwork to handle. However, a recent harvest of non-bank finance technology (Fintech) creations and startups that are known as neobanks are removing, combating or reducing these stereotypes, categories and labels by the digital-first form of banking platforms —frequently, digital-only— that bring low cost and fees to its services and products with online experiences (Martinčević et al.,2020).

So, what is a neobank? A neobank is one of the most challenger banks as known around the society and within the industry due to its new form and its abnormal, non-ordinary style and system. It is a fintech firm that develops an online platform to offer its products and services through app, software, web and more seamless online technologies to deliver its products and services with no actual physical branches like normal banks. Some of the products and services of finance included in neobank similar to the basic of saving account and also checking account. The tendency of neobank transparency tends to be more than normal banks even, though, neobanks partner with many of ordinary finance, banks institutions. Moreover, in United State, these fintech firms called and referred to as neobanks while challenger banks came firstly from the United Kingdom referring to startups of fintech banking which is developed, appeared and emerged in the wake of 2008 financial crisis that major banks in U.S declared bankruptcy (Temelkov Z, 2020).

Challenger, the nickname is clever, fitting and appropriate. These firms are often compared to digital interrupts event, activity or process by causing a disturbance, issue or problem. However, nowadays, this revolution is transferring and transforming the sector of banking in systems and ways similar to the revolution of Airbnb that revolutionized the hospitality industry and similar to Grab in Malaysia overhauled transportation. Attracting consumers to neobanks in U.S through big name brand in crowds, droves and flocks. For instance, Chime had 12 million clients in 2021 February which is an increase from 8 million last year. Moreover, research by Exton Consulting, in 2020 December, a firm that makes strategy and management consultation to the finance sector established and founded in Paris, France, found that the number of neobanks around the world is 256 neobanks globally.

Neobank is considered to be an online bank, but it should not be confused with online banks. Neobank is an online-based banking platform only that absence and lacks physical branches. In other words, generally, online banks have the characteristic of a bank and deliver a wider variety of financial products and services to their customer, including wealth management, loans and other services. For example, Ally Bank is an online bank. However, the fast and increase of fintech growth made neobank popularity increase fast that players have to improve their services and products to cope with the nascent neobank industry. For illustration, no-fee checking accounts and no minimum balance requirements at Capital 360.

2. Gaps that solved or addressed by this FinTech innovation:

The neobanks is a fintech solution to underbanked communities. 2020 brought the rise to a fintech solution and disturb the way of traditional banking systems (Jiang et al., 2021). This is the Neobanks which are a mobile indigenous alternative to ordinary banks-based branches. Neobank is considered to be a startup in many countries while in some others they have been existing a long ago. However, these Neobanks for example similar Atom in UK, Money Lion and Dave in U.S brought services and products similar to traditional banks and more including saving account, checking account, peer-to-peer, prepaid cards, advance paycheck and investing through mobile—Robo-advisors. Although these apps and Neobanks were available before 2020 and have many consumers adopted them, the high-pitched and sharp recession caused by the Covid-19 increased the adoption of neobanks and, therefore, made it a lifeline to the economy in U.S to more than thirty million unbanked and underbanked household. For instance, neobanks made it faster to receive stimulus by the government, transfer of cashless money to people in need or feature to help cover daily necessity, many individuals and household relied on neobanks to cope with this challenging time and to weather the storm (Borges et al., 2020).

Before 2009, almost 9 million American households, 7.7% of U.S.A are in areas that had limited access to the services and products of traditional banks (Buku et al., 2012). However, most of the banks neglected these low-income areas due to enhance shareholder profitability by focusing to generate more income. These large banks, conventional banks and commercial banks depend on when generating profit on services similar mortgages, credit cards and loans to high profile clients. This negligence of lower-income elements with a nonexistent credit history or

damaged credit history and also due low balances of accounts. Furthermore, the aftermath of the recession of 2008 crisis and responding to regulatory similar Durbin Amendment measures, conventional banks raise the maintenance fees to its hike monthly which caused underbanked clients to cancel and withdraw their money from the accounts. These unbanked communities reached to be 10 million in 2011 that is all-time high leading to worsen the matter. However, these unserved, underbanked and unbanked homes are in towns with limited funding of public education programme, opaque fees and penalties due insufficient funds have eroded the trust in banks by these communities (Mukharlyamov et al., 2019).

Due to these new regulations, the underbanked communities are hurt. However, Neobanks is a different and new system to transferring, purchasing and investing money. As always when a door closed— due the Durbin Amendment— a new door to neobanks is opened to enter the market and serve these underbanked. The difference between neobanks and traditional banks is that the fees are less—minimum fees— or no fees at all. Neobanks earn profit by the interchange fees on the purchases, the fees in a peer-to-peer network and the spread of investment. Moreover, the platform and apps of neobanks did fill up the wide market gap. For example, some of the features helped to fill the huge gap through giving the underbanked clients a feeling of financial security similar overdraft loans, advance paycheck and feeless ATM withdrawals. Please see figure 2.1 and 2.2 in appendix.

Finally, some new technologies enabled neobanks to reach these underbanked communities and enhance their apps and platform, innovated financial products and profitability acquire a customer. Some of these fintech systems are API-Based Card Issuance, Digital Payment, Cyber-security and Data Protection, Social Media -Enhancing User Economics and Fractional Shares— the gate to neobank investment products. For illustration, traditionally banks' process to issue cards is much harder than API-based card issuance, it includes production, authorization and more steps that make the process cumbersome. However, new banks reduced the barriers. Also, through digital payment, neobanks made it easier than ever to purchase as to merchants to accept the payment by digital wallets— mobile wallets. Moreover, fractional shares made it easy to invest, mutual funds require a high minimum amount, in companies such google for as little as \$1 at a time. Furthermore, API-driven brokerage infrastructure providers like DriveWealth suppliers enabled mobile banks to have features such as fractional shares trading, Robo advisor portfolio and stock-back loyalty rewards (Mehdiabadi et al., 2020).

3. Xinja failed case of FinTech:

There are some reasons why fintech start-ups fail. Some of the common reasons that make these start-up end closing are underfunding, wrong investment, compliance problems, marketplace competition and economic downturn. However, the top common, and shared reason between all failure, collapse and closing doors of fintech start-ups is lack of funding. Many managers when run out of funds in the bridge between the second round of funds they end up out of money which forces the firm's closure.

Eric Wilson the founder of Xinja in 2017 at Sydney Australia reach total funding when disclosed of \$100.6MM. Xinja was a neobank to in the market for clients that offer many products and services to consumers like debit cards, bill payments, deposit accounts and money transfers and more. Xinja developed an app for both IOS and Android devices. Moreover, the firm also launched the Stash platform to alternative consumer saving accounts. Said Xinja “ due increasingly difficult capital raising environment after a year of pandemic, and following the analysis of the market in Australia, the firm had chosen to withdraw the bank account and Stash, saving, account and terminate being a bank” (Boyd, 2021).

Last year in December 2020 the firm had only one option and was forced to end its license due fatally haemorrhaging cash for more than 12 months and, therefore, to return all deposits from customers. The postmortem showed that the activities of the firm engaged in spending carelessly while it lacked a specific, single and particular source of fund, profit and revenue or a lending product (Ford, 2019).

Additionally, Xinja neobank incinerated, destroyed and burned almost \$98 million of the capital of shareholders through presenting one of the maximum deposit rates and filled to offer loan services and products that would be a source of fund, sufficient revenue to maintain the firm operation. However, the banking 101 role is to match its liabilities (deposit) to an asset (loans) to create margin interest that would be enough to cover its daily operation, expenses and make revenue (Collins, 2018).

Finally, the firm failed due reliance, faith in and leaning on shareholders entirely to fund the deposit which increased to \$484 million in 2020 September. However, the firm was able to return all funds to depositors and clients and currently the accounts lying on a balance of less than \$100,000 included accounts of a balance between \$5 to \$1. Hence, no depositors,

consumers and investors were harmed and no borrowers defaulted (Johnson, 2021).

4. Biggest challenges slowing the growth of neobank and how to resolve it:

Neobanks are fintech which means finance and technology and it built the entire neobanks on technology— online platform—model, therefore, in case the technology is disrupted it will lead to foremost a series and major problems (Omarini, 2018). However, based Xinja case study some of the major issues, problems and challenges that would slow the growth of this FinTech innovation, neobanks are erosion of differentiator, regulation, convincing people to adopt, coronavirus impact and the need of financial institution (FI) as a partner.

First challenges are erosion of differentiators that is Neobanks should keep improving their products to keep with the changes as competitors adopt new technology faster, even, though, the original ideas of these neobanks differentiate themselves through offering new, distinctive and extraordinary deals f products and services.

Next challenges that the regulation build, prevent and raises the bar to all not only Xinja firm. Therefore, neobanks would be challenged to adapt to endorse the framework by the government. For example, in Malaysia, the government will allow only neobanks, full digital banks to open as beginning and they must first show a case and go through the regulatory framework and thereafter, only 5 of all applicants would be approved, hence, the framework is fairly complex.

Besides, the customers, investors and households have usually been slow when it comes to new technologies adoption. There are five stages when it comes to adoption of new technology are innovators— adopt first, younger age, more risk, higher social class, access to wealth and have access to scientific resources and other innovators—, secondly stage of adoption is early adopter— opinion leader—, thirdly early majority adopt to new technology due to utility and practicality, the last two stages are late majority and laggards which will adopt only after the average person and the technology should first become widely accepted, hence, impossible to ignore. For example, in UK the adoption is faster than in U.S and it shows only 3% of millennials in U.S have adopted neobanks in the past 8 to 10 years (Duane et al., 2017).

Moreover, one of the major reasons and challenges caused Xinja is the pandemic in Australia. After 16 months in the pandemic, the firm had been unable to generate revenue and cover the daily cost and its withdrawal of funds and repaid its obligation to both investors and depositors due lack of funds. The firm was only dependent on stakeholders to satisfy its needs

while not making even one sufficient source of funds. However, neobanks must, not should build a strong foundation when it comes to customer base. That means to make as much as possible to convince people, individuals, and households to switch accounts from other providers. For example, in UK the number of people switching to neobanks is only about one million in the year of 2017 to 2019 which is a small population percentage. Also, to build a sufficient base, loyal customers- base to have the ability to grow would take time which most of neobanks forget or they have it but not in abundance and large quantity.

Eventually, the relationship of neobanks with FI is hard to be removed, in fact, these FI has huge power over neobanks because it is hard to remove the relationship between the consumers and FI— ordinary, traditionally banks— or move this relationship to be direct between neobanks and the depositor, consumers and household. For example, people have the fear of moving money from one firm to another. Therefore, how to change people's minds and old ways to adapt to this new innovation of FinTech. Furthermore, in case of neobanks has no FI partner they would not have the ability to ensure the deposit which is a major challenge of expanding the consumers-base and also it may cause issues, problems and stunt the rapid growth of neobanks.

5. Regulations and initiatives to promote and develop the neobank in Malaysia:

Malaysia's regulator and government agencies had taken steps to promote and develop the FinTech (neobanks) segment. An overview of the regulation taken by the steps that first they obtain to get a license. Therefore, when the application of a company’s got through the process, they should open for 5 years limit within the asset. The process to get a digital license, please see figure 5.1 below:

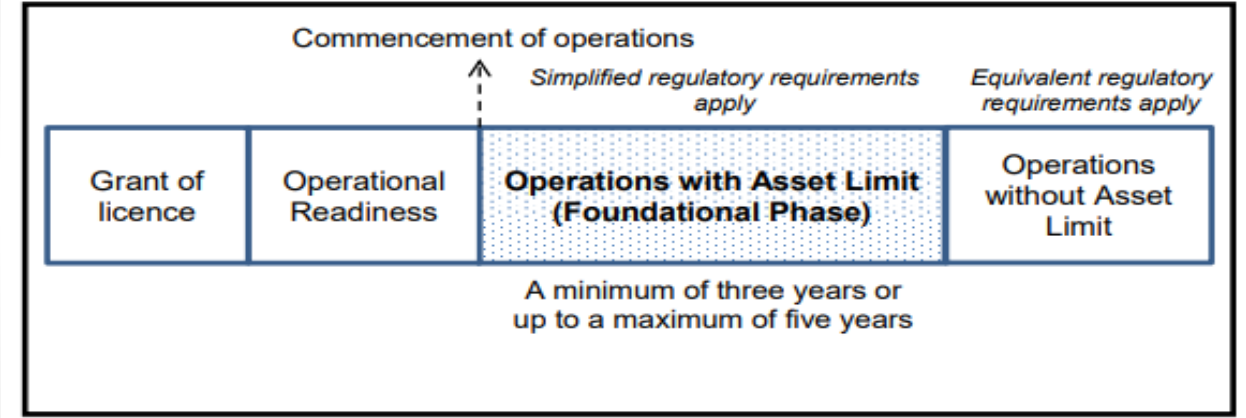


Figure 5.1: Illsturation of licnse progression

However, a licensed digital bank should first maintain RM100 million of capital funds as a minimum and it would be subject to business limitations and regulatory framework. Firstly, a business limitation is that total assets during the foundational phase do not exceed RM2 billion. Secondly, the licensed bank should follow the requirement of a commercial bank or Islamic bank except in capital adequacy, liquidity, stress testing, public disclosures (pillar 3) and Shariah governance. Please see the framework table 5.1 in the appendix.

Next, it should have regular engagement with the bank to make sure it is complying requirements of either commercial or Islamic banks. Also, it can obtain prior written approval in case it wishes to adopt the equivalent regulatory framework which the bank will assess among overall risk management, compliance policy, practices, size, the complexity of the operation and business model. To other requirements than mentioned above the bank will apply equivalent requirements of a banking institution. Finally, the licensed digital banks must comply with any further requirements by the bank (Negara, 2021).

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7. Appendix

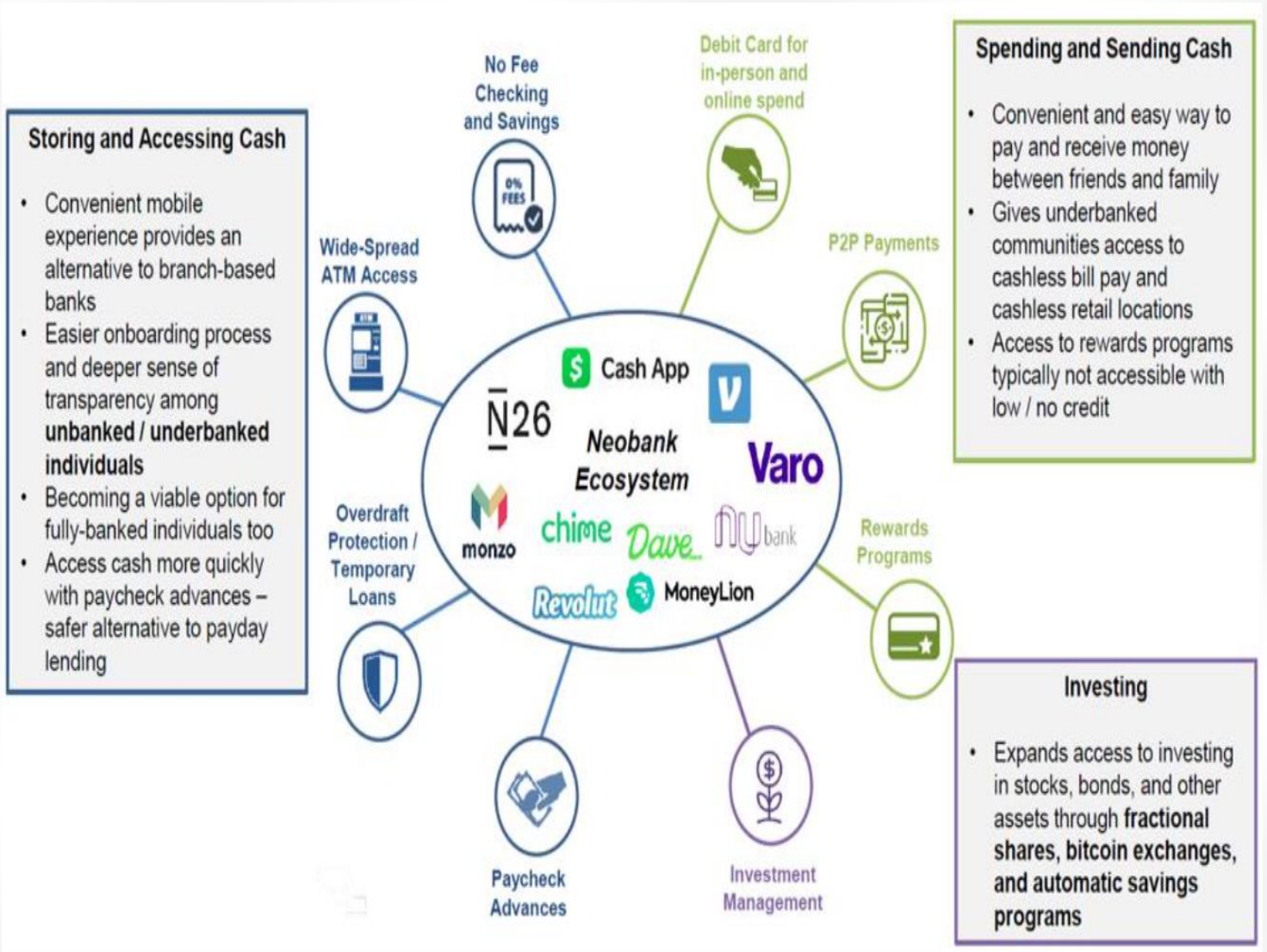


Figure 2.1: Neobank products and services

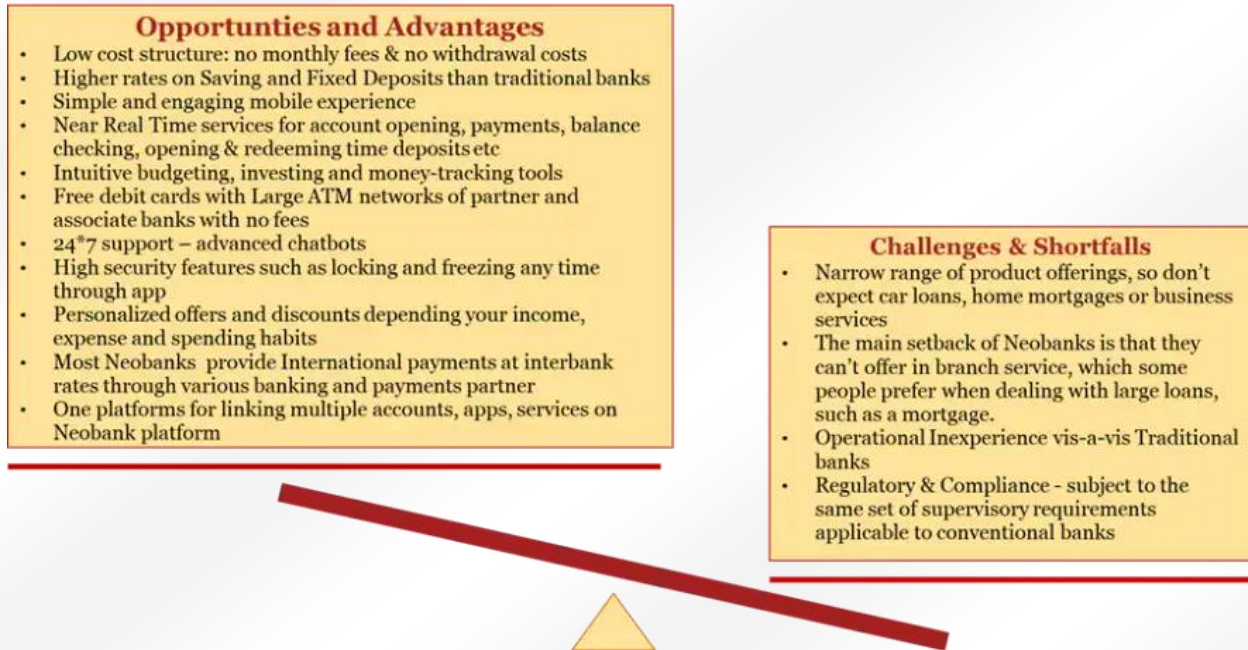


Figure 2.2: Neobank advantages and disadvantages

Table 5.1: Regulatory framework

Areas of simplification or exemption to the existing regulatory framework	
(A) Capital Adequacy	<p>(a) A licensed digital bank shall maintain a minimum Total Capital Ratio (TCR) of 8%, computed based on the following:</p> <p>Capital Components</p> <ul style="list-style-type: none"> (i) All requirements in the policy documents on Capital Adequacy Framework (Capital Components) and Capital Adequacy Framework for Islamic Banks (Capital Components) shall apply, except where stated otherwise below. (ii) Only Common Equity Tier 1 (CET1) capital shall be recognised as eligible regulatory capital. (iii) Capital buffer requirements, including the Capital Conservation Buffer and Countercyclical Capital Buffer, shall not apply. <p>Risk-weighted assets</p> <ul style="list-style-type: none"> (iv) All requirements in the policy documents on Capital Adequacy Framework (Basel II – RiskWeighted Assets) and Capital Adequacy Framework for Islamic Banks (Risk-Weighted Assets) shall apply, except where stated otherwise below. (v) For credit risk, only the Standardised Approach shall apply, with modifications as set out in Appendix 1. (vi) For operational risk, only the Basic Indicator Approach shall apply. (vii) For market risk, only the Standardised Market Risk Approach shall apply, with the following modifications: <ul style="list-style-type: none"> i. For interest/profit rate risk exposures, the requirements as set out in Appendix 2 shall apply. ii. Equity, commodity and inventory risk exposures shall be treated as banking book exposures, and subject to requirements in Appendix 11 ; and iii. For options risk exposures, only the delta-plus method² shall apply. (viii) The large exposure risk requirement (LERR) shall not apply.
(B) Liquidity	<p>(a) A licensed digital bank shall hold an adequate stock of unencumbered Level 1 and Level 2A high-quality liquid assets (HQLA) equivalent to at least 25% of its total on-balance sheet liabilities.</p> <p>(b) All general and operational requirements relating to the eligibility of Level 1 and Level 2 HQLA shall refer to those set out in the policy document on Liquidity Coverage Ratio (LCR)³.</p>

(C) Stress testing	(a) A licensed digital bank shall be exempted from the requirements under the policy document on Stress Testing.
(D) Public Disclosures (Pillar 3)	<p>(a) A licensed digital bank shall be exempted from the requirements under the policy documents on Risk-Weighted Capital Adequacy Framework (Basel II)– Disclosure Requirements (Pillar 3) and Capital Adequacy Framework for Islamic Banks (CAFIB)– Disclosure Requirements (Pillar 3).</p> <p>(b) A licensed digital bank shall include the following information as part of the explanatory notes in the financial statements:</p> <ul style="list-style-type: none"> (i) Breakdown of gross risk-weighted assets for each risk component; and (ii) For credit risk-weighted assets, the breakdown of the various categories of risk weights.
(E) Shariah Governance	<p>(a) All requirements in the policy document on Shariah Governance shall apply to a licensed digital bank carrying on Islamic digital banking business, except where stated otherwise below:</p> <ul style="list-style-type: none"> (i) Shariah Committee must comprise at least three members; and (ii) Shariah Committee must convene at least two times a year.