Black paper
#1
In addition, as digital only banks don’t need branches, fixed costs are lower than those of traditional banks. Digital-only banking also provides larger banks the opportunity to target another customer segments and to increase their footprint in the banking sector.

What has changed so far since the 90s? Customers are better informed and they are technology-savvy. Nowadays, customers have various products in different banks and have optimised their costs depending on their product needs.

Technology has changed a lot; it enables financial institutions to automate processes and create innovative products. Analytics also help banks to gain better insight into which products generate the highest revenues and who are the most profitable customers. This also enables the banks to better meet their customers’ expectations. Financial institutions focus on customer-centricity with an end-to-end approach and create new business models as they re-think the way banks interact with their customers, far instance, by taking into account the banking ecosystem.

Regulations are usually a barrier for setting up a digital-only bank: even if some regulations are less stringent for new entrants, they still must comply with the majority of regulations such as PSD2, and GDPR etc. That’s why some digital-only banks partner with big financial institutions to benefit from their technology, banking licence or even reputation. However, other digital-only banks prefer doing all the processes on their own, without any partnerships.

The main advantages of a digital-only bank are low costs, product innovation, banking services availability (24/24, anywhere and on any device), specific target customers, improved customer experience, and financial inclusion. However, creating a digital-only bank can also be a puzzle in terms of regulatory requirements, gaining customer trust, security, technology and the customer segment targeted. There is also the challenge of the lack of personal relationship due to the branchless model without face-to-face contact.

This document develops all those challenges in detail. It shows the importance of creating a robust business model, finding the right way to differentiate your business from the other players through technology or product innovation. This paper answers questions raised by financial institutions when they plan on setting up a digital-only bank.
Introduction

Why is setting up a digital-only bank advantageous? What are the risks and the opportunities related to creating this sort of entity? How to avoid this domain’s entry barriers?

This document defines digital-only banks. It also covers the emergence of digital-only banking and how it is going to further develop in the future. For instance, in the future, we can imagine new customer journeys and some external players in the offering. The differences between a digital-only bank and traditional banks are also highlighted.

Then, the current state of digital-only banking space in Europe is depicted. It includes major European trends such as changing customer behaviour, regulatory changes or even evolving business models.

Afterwards, some examples of existing players are mentioned with their offering and their key differentiators. Existing players can either be part of a big bank, or a totally new entity - often called challenger banks.

Finally, the advantages and the challenges faced by the various players on this market are developed. Digital-only banking can lead to higher monetary benefits or enable better product innovation as the entity usually works with a more agile approach.

The document concludes with two case studies: one on Rabobank International Direct Banking and the other on Evi. The reasons why they’ve moved to the digital-only banking area and the challenges they’ve faced are highlighted in those case studies.
Digital-only banks created to diversify business

Brick-and-mortar banks have also been offering services directly to the customer through telephone, online and mobile banking channels for quite some time now. However, when regulatory requirements were relaxed post the 2008 financial crisis to encourage new market entrants, the digital-only banking space was revolutionised by a host of non-traditional, financial technology players with unique offerings such as car manufacturers, telcos, retailers, insurers, challenger banks, payment banks, neo banks, and even the usual technology companies such as Google and Apple.

Intense competition from non-traditional players has prompted many high street banks to transform their omni-channel banking technology or begin new digital-only banking operations under umbrella names. Some of them are even expanding to newer geographies with digital-only banks. As part of the One Belt One Road initiative, Chinese banks already operating in Europe are set to increase their footprint by launching Private Banks and Digital-only banks to tap into the expanding pool of Chinese residents living in Europe. Another example for this is DBS Bank (Development Bank of Singapore) that launched a ‘mobile-only bank’ in India, in April 2017. The bank uses biometrics and artificial intelligence, to make the banking experience completely virtual.

Some of the stark differences between a traditional brick-and-mortar bank’s digital offering and a digital-only bank are:

For a financial institution, creating a digital-only bank is a way to diversify business and generate new revenue streams. However, core activity digital transformation is vital to stay in the race.

### DIFFERENCES BETWEEN THE DIGITAL ARM OF TRADITIONAL BANK AND PURE DIGITAL-ONLY BANK

<table>
<thead>
<tr>
<th>Digital offering of Traditional Bank</th>
<th>Digital-only bank</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overview</strong></td>
<td><strong>Strategy</strong></td>
</tr>
<tr>
<td>• Physical and virtual presence</td>
<td>• Specific set of simple products and services, which differentiate them</td>
</tr>
<tr>
<td>• Standard banking licence</td>
<td>• Analytics-driven personalised products</td>
</tr>
<tr>
<td><strong>Technology</strong></td>
<td>• Transparent structure of fees</td>
</tr>
<tr>
<td>• Legacy platforms with modern</td>
<td>• Lower commissions</td>
</tr>
<tr>
<td>channels</td>
<td></td>
</tr>
<tr>
<td>• Function as stand-alone entities</td>
<td></td>
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<tr>
<td>• Straight through processing for</td>
<td></td>
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<tr>
<td>select processes</td>
<td></td>
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<tr>
<td>• Modern FinTech platforms with cloud based solution</td>
<td></td>
</tr>
<tr>
<td>• Stand-alone or Partner with banks to leverage facilities such as ATMs</td>
<td></td>
</tr>
<tr>
<td>• 80% – 90% Straight through Processing</td>
<td></td>
</tr>
<tr>
<td>• Dedicated agile structure</td>
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</tbody>
</table>
The current state of the digital-only banking space in Europe

The prevalence of digital-only banking in Europe can be traced back to the aftermath of the 2008 financial crisis, where numerous waning banks were either merged or acquired by larger banks. For instance, in a 2011 report by the Independent Commission on Banking (ICB), major banking groups such as Barclays and HSBC accounted for almost 90% of market share in current accounts in the UK, but faced relatively low customer satisfaction levels. This triggered the need to ease regulations for newer market entrants to encourage competition.

Ever since, the UK and Europe have played host to numerous disruptors in the financial services industry that have taken technology and customer experience to a whole new level. The European Banking Federation (EBF) reported in 2016 that banks shut down over 9,000 branches and shed nearly 95x189

Research by Bain & Company revealed that “if the 25 largest US banks reached the level of mobile and online banking use of their counterparts in the Netherlands, they would significantly improve their Net Promoter Score (NPS) and save $11.4 billion annually on the declined use of branch and call-center” (1)

One of Germany’s largest digital-only banks, ING-Diba, has over 8.8 million customers, making it the third largest bank in the country. In 2016, it reported an annual growth of 24% in the number of checking accounts.
50,000 staff across the region, even as the pace of digitisation of banks and investment in FinTech start-ups rose. One of the early adopters of digital-only banking has been the Netherlands that began to reconfigure its bank branches and move to cashless transactions almost a decade ago, enabling customers to adopt mobile banking early on. Other countries to have made significant strides in digital-only banking adoption are Germany, Belgium, France, Sweden and Poland. In fact, digital-only banks in Germany held a 14% market share of all retail banking, with deposits of €286 billion, and 18.2 million customers by the end of 2016. Its customer base is touted to further grow to 22 million by the end of 2020 (2).

Some of the key trends in digital-only banking can be identified as following:
- The evolving customer
- Multi-banking customer behaviour
- Technology and product innovation
- Regulatory environment
- Examples of existing players

### 1. The Evolving Customer

Evolving customer behaviour and preferences have been chief drivers of digital-only banking, owing to changing customer demographics such as location, age, and income, to name a few. Barring a few outliers, most of the European nations (including the UK) are developed, and have high levels of literacy, standard of living, wages and technological infrastructure. Hence, customers are well-informed, technologically sound, and have high expectations from their banks in terms of monetary incentives and a superior user experience.

47% of mobile device owners in Europe were banking by mobile, according to an ING survey of 15,000 people in 2016. And this rate continues to increase over the years.

### 2. Multi-banking customer behaviour

Another factor of critical importance is simply the multitude of choices available. Unlike earlier days, switching banks is much easier and preferred, should there be better benefits or user experience. Customers are also more willing to multi-bank, choosing different banks for different services. For instance, in a 2017 survey by YouGov that included over 2,000 UK banking consumers, more than half of the respondents chose to multi-bank to avail the best products with each of them rather than banking with a single institution.

#### Top incentives for changing bank

<table>
<thead>
<tr>
<th>Incentive</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Incentive (better rates, cash back, discounts, etc.)</td>
<td>32%</td>
</tr>
<tr>
<td>Dissatisfactory customer service with prior bank</td>
<td>11%</td>
</tr>
<tr>
<td>Not sure</td>
<td>16%</td>
</tr>
<tr>
<td>One provider for all the products I require</td>
<td>30%</td>
</tr>
<tr>
<td>Multiple providers with the best offering for each product</td>
<td>54%</td>
</tr>
</tbody>
</table>

#### Customer preference for multi-banking

<table>
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</table>

Source: YouGov
Hence, customer acquisition through digital-only banking has become easier and at the same time highly competitive, due to the rising number of players in this space. In the figure below, 28% of retail banking executives across the continent expressed customer acquisition higher than 20% through direct channels. The trend is visibly higher across some Central and Western European countries such as Germany, France, Belgium, the Netherlands, Hungary, and Czech Republic, where the customer profile and the technological infrastructure are slightly more evolved. In fact, the study highlighted Belgium, where about 38% of banking executives expressed new customer acquisition of over 20% through direct channels.

One of the foremost key differentiators of digital-only banking players is the use of innovative and efficient technology. Hence, most digital-only players have dedicated their efforts to establishing a niche technological setup, with lean/agile systems and hosted solutions for their online and mobile banking. Most of them also utilise a variety of technologies such as APIs, analytics, and advanced UI/UX to offer smart and simple-to-use products. Product innovation is another key factor that has set apart non-traditional players. Most of them have simpler product lines and streamlined operations that ease customer navigation through the bank’s offerings. This appeals to the millennials especially, who tend to bank-on the-go. There are three models related to the technology used by digital-only banking players:

1. The first one is a full in-house developed technology. Such approach gives the bank complete control over the full value chain. An example for this is Fidor Bank, which has its own in-house developed technology.

2. The second model the majority of the players seem to have adopted is partnering with established vendors or start-ups, to acquire the best-of-breed applications.

3. Some financial institutions have also resorted to a mixed approach, with different technologies from different vendors, both established players and start-ups.

Along with the advanced technological setup, some banks have developed unique offerings that drive innovation and customer experience a notch higher. A good example of this is Santander Bank, UK. In 2016, it launched ‘voice banking’ through which customers could converse with their SmartBank app about simple queries such as card spend, thus eliminating the need to manually search through statements. It also became the first UK bank to introduce Blockchain technology for international payment transfers.

3. Technology and product innovation

About 85% of top IT leaders at banks across Europe feel that newer business models from challenger banks are fast acquiring significant customer appeal, compared to traditional methods.
Banks need to reinvent themselves to remain their customers’ single point of contact. They need to create an end-to-end value proposition including other third parties to diversify their offering. Integrating the new ecosystem by opening its system becomes vital and enables the banks to evolve much quicker than before. The world is not standing still, it is constantly being reinvented: that’s why it’s difficult to predict the bank of tomorrow. The solution for keeping up-to-date is openness as banks can more easily adapt than if they had to create each change from scratch. In this case, unity makes strength comes in numbers.

Last but not least, technology and product innovation enables banks to be much more efficient than before, mainly thanks to analytics. Financial institutions can focus on efficient products, knowing which ones are profitable for them. An example of this is Santander UK, who simplified its current-account product suite from 100 products to less than 10.

4. Regulatory environment

The rise of the non-traditional players in the digital-only banking space has largely been motivated by the slight flexibility in the regulations that they need to comply with. Most of the time, this is simply because of their banking models. For instance, challenger banks partnering with a traditional bank are exempt from applying for a separate banking licence. For independently functioning entities, the EU and UK governing authorities such as Competition and Markets Authority (CMA), Financial Conduct Authority (FCA), and the European Banking Authority (EBA) have introduced numerous relaxations such as simplified Basel 2 requirements, and acceptance of virtual currencies as commodities, etc. On the other hand, challenger banks have objected to several regulations that continue to remain uniform across all banking models, creating complexity as full compliance imposed on big banks is also applied to small banks. The most significant of which is the high capital requirement for challengers (owing to low credit history), and limited access to payment systems.

Besides these specific examples, a bevy of regulatory changes are set to bring some of the biggest changes to the European banking environment, making it more open, transparent and competitive. At the other end of the scale, it could also create a more difficult operating environment especially for legacy players, considering the magnitude of infrastructure, regulatory and legal changes that would be required. Listed below are some of the important regulatory changes anticipated in the coming months, and potential repercussions.

A) PSD2

The EU Payment Services Directive 2 (PSD2) that is expected to come into effect this year, marks a significant step towards ‘Open Banking’ by allowing any third-party payment (TPP) service providers to access customers’ data from their bank account, subject to consent. Among other things, the directive would facilitate greater transparency between international payments by minimising hidden fees, forbid non-transparent pricing methods, enforce stronger identity checks for online payments, and allow TPPs to aggregate multi-account holding customers’ account information.

With the enactment of this directive, the market will be further open to competition from non-banks, as well as from smaller, emerging banks. However, larger banks will be under further pressure to enhance their technology and product customisation, to be able to stay resilient.

B) Open Banking

While PSD2 is EU focused, the UK is coming up with a similar version of its own directive called Open Banking, thus enforcing the concept of data sharing, irrespective of Brexit. This initiative is led by the Open Banking Implementation Entity (OBIE) governed by CMA and funded by the UK’s nine largest banks and building societies. Much like PSD2, Open Banking, which came into effect in January 2018, delivers Application Programming Interfaces (APIs), data structures and security architectures that will make it simpler and safer for customers to share their financial records with third parties.

More generally, Open Banking is also a market trend for banks in other European countries and implies better integration of the financial ecosystem from the banking players.
The General Data Protection Regulation (GDPR) came into effect in May 2018 across the EU and mandates all businesses to protect personal data and privacy of EU citizens for transactions that occur within EU member states, as well as notify any security breach within three days of incidence. Any events of non-compliance will incur heavy fines. This implementation will compel all digital-only banking models that are heavily technological-dependent, to adopt high level of data protection measures.

Apart from the aforementioned changes, both the UK and the EU are contemplating simplification of some current regulations, to suit simpler banking models of non-traditional players. Two changes anticipated in the coming months are revisions in reporting requirements to reduce administrative burden, and loosening of Pillar 2A capital requirements to aid flexibility on mortgages. The European Central bank (ECB) is also contemplating introducing new, simpler licensing guidelines for FinTechs firms. These changes could further spur competition in the non-traditional banking players’ space, and encourage further bank-FinTechs partnerships while entering a new market.

In March 2019, the UK is expected to officially exit the EU. With this, one of the significant changes in the financial services sector would be the exit of UK from the EU passport system or the Single Market Directives that currently allows any firm located in EU or EEA (which currently includes UK), to trade within the continent with minimal additional authorisation. Post Brexit, UK based financial firms that are also located in the EU and vice versa, will need to review their banking licenses, and the necessary approvals. Other changes pertaining to the ‘single rule book’ that currently apply to both EU and the UK will also compel firms to amend their systems and policies accordingly. On a positive note, the UK government would have better discretion with regards to introducing reforms that are more suitable for UK market conditions.

For banks, the most important transformation in the digital space is to develop a real “Customer Centric” relationship.

How can we move from a model where the bank was at the centre to a customer-centric model now that the customer wants to decide everything?

Banks and other players exist around by positioning themselves on their customer journeys. Financial institutions have huge assets to undertake this transformation: They have a very important trust capital with their customers and key financing products to support customers in their life milestones.

But they must change two major things to be in line with digital expectations:

1. Better use the data they have on their customers in order to anticipate customers’ plans and needs. Banks must position themselves at the start of their customers’ life milestones.
2. They must also support customers with an end-to-end approach with their plans and not only around their financing products. For this, they must rely on an ecosystem of partners and FinTechs.

By doing this, the bank supports their customers at every stage of their lives and prevents their de-intermediation. In addition to that, financial institutions can develop new sources of revenue as the margins on conventional products are becoming lower. Then, they offer a complete and differentiating customer experience on the market.

This major transformation leads to the emergence of new business models for banks. The bank of tomorrow, direct or not, will remain a bank but also a data bank, an orchestrator of trusted services, a super distributor of services centred on new customer journey. Creating a digital-only bank is a great opportunity for traditional banks to completely re-think the way they interact with their customers and implement new customer-centric end-to-end journeys and processes.
The umbrella of digital-only banking players includes various mobile apps, websites, or a combination of these, and ranges from the renamed bank to challenger banks, neo banks, payment banks, P2P lenders, etc. These can be broadly categorised in two groups as follows:

### Examples of existing players

The most prominent in this group are the challenger banks that typically have a differentiator related to a product or geography. Hence, they aim to serve specific markets profitably and mainly target multi-banking millennials. For example, a challenger lender bank is likely to target customers with more complex needs rather than the “vanilla prime” segments. Listed below are some key players that have gained prominence:

<table>
<thead>
<tr>
<th>Name</th>
<th>Founded in</th>
<th>Locations</th>
<th>Channels</th>
<th>Key offering</th>
<th>Products / Services</th>
<th>Key differentiators</th>
</tr>
</thead>
<tbody>
<tr>
<td>BinckBank N.V.</td>
<td>2000</td>
<td>The Netherlands, Belgium, France, Italy, Spain</td>
<td>Online</td>
<td>Online brokerage services</td>
<td>Trading, Investing and Saving services</td>
<td>One of the first online brokerage services in Europe, it also became the first to acquire a rob-advisory firm in continental Europe with the acquisition of Pitié based in the Netherlands</td>
</tr>
<tr>
<td>Lynx</td>
<td>2006</td>
<td>The Netherlands, Belgium, Germany, Czech Republic, Finland, Slovakia</td>
<td>Online, mobile and tablet</td>
<td>Online Investment</td>
<td>Trading and Investing through the LYNX trading platform and trader tools</td>
<td>Over 40,000 investor accounts by 2017</td>
</tr>
<tr>
<td>N26</td>
<td>2013</td>
<td>Germany, Austria, France, Spain, Italy, UK, US</td>
<td>Mobile only</td>
<td>Basic current account, Debit MasterCard</td>
<td>Account opening through video chat, Real-time notifications, multi-lingual customer support, no fees for basic transactions</td>
<td>Europe’s first mobile bank; one of the few German banks with multi-lingual interface</td>
</tr>
<tr>
<td>Atom Bank</td>
<td>2014</td>
<td>UK</td>
<td>Mobile and Tablet only</td>
<td>Fixed Saver, Mortgages</td>
<td>Biometric validation (face and voice recognition), Digital mortgage services, Predictive expense forecasting, Savings advice</td>
<td>First digital only challenger bank to be granted a full UK regulatory license</td>
</tr>
<tr>
<td>Starling</td>
<td>2014</td>
<td>UK</td>
<td>Mobile only</td>
<td>Current account services</td>
<td>Real-time account activity updates, Biometric authentication, Spending insights, Smart money and card management</td>
<td>First licensed UK bank to have a public banking API, that enables integration with other financial services</td>
</tr>
</tbody>
</table>
These are examples of digital-only players that either are launched or operate in partnership with traditional banks. Hence, they rely on their partners for the technology, banking licence or their reputation. For instance, RaboDirect doesn’t hesitate to promote the AAA scoring of their parent company. This could include digital banking start-ups (popularly termed as Neo Banks) that have partnered with the larger banks or the digital-only subsidiaries launched by the larger banks. Examples are:

<table>
<thead>
<tr>
<th>Name</th>
<th>Founded in</th>
<th>Locations</th>
<th>Channels</th>
<th>Parent/Partner Firm</th>
<th>Products/Services</th>
<th>Key differentiators</th>
</tr>
</thead>
<tbody>
<tr>
<td>MoneYou B.V.</td>
<td>2001</td>
<td>The Netherlands, Belgium, Germany, Austria</td>
<td>Online</td>
<td>ABN Amro bank NV</td>
<td>Current and Savings account, loans and mortgage services</td>
<td>Signed an agreement with SolarisBank in Dec 2017, to provide instant digital loans of €1,000 to €35,000</td>
</tr>
<tr>
<td>Rabobank International Direct Banking</td>
<td>2002</td>
<td>Belgium, Germany, Australia and New Zealand</td>
<td>Online, mobile, tablet</td>
<td>Rabobank</td>
<td>Savings with a focus on the food and agricultural financing</td>
<td>Cooperative bank, one of the first which chose to diversify to offer a more digital service to better reach the food and agriculture sector</td>
</tr>
<tr>
<td>Boursorama Banque</td>
<td>2005</td>
<td>France, Spain</td>
<td>Online, mobile, tablet</td>
<td>Société Générale</td>
<td>Trading, current account, Personal finance management, life insurance, mortgage, consumer loans</td>
<td>Weak banking fees, free banking card, economic news</td>
</tr>
<tr>
<td>Hello Bank!</td>
<td>2013</td>
<td>Germany, Belgium, France, Italy, Austria</td>
<td>Mobile and Tablet</td>
<td>BNP Paribas</td>
<td>Banking, Brokerage, Insurances, Loans, Savings</td>
<td>Multi locations, includes auto loans, mortgages, insurances, brokerage and savings</td>
</tr>
<tr>
<td>Evi</td>
<td>2013</td>
<td>Belgium, the Netherlands</td>
<td>Online and mobile</td>
<td>Bank van Lanschot</td>
<td>Investments, Pension plans</td>
<td>Investments can be related to a goal to reach interesting rates compared to the market, possible to plan its retirement funds</td>
</tr>
<tr>
<td>Orange Finanse</td>
<td>2014</td>
<td>Poland</td>
<td>Mobile</td>
<td>mBank</td>
<td>Current and Savings account, NFC and online payments, mobile-enabled ATM withdrawals and account management</td>
<td>Over 350,000 customers by the end of 2016, Plans to launch in Slovakia</td>
</tr>
<tr>
<td>Kontist GmbH</td>
<td>2016</td>
<td>Germany</td>
<td>Mobile</td>
<td>Partner with SolarisBank, Debitoor</td>
<td>Business account, tax calculation, automated bookkeeping, expense management minded MasterCard</td>
<td>First German banking solution launched exclusively for freelancers</td>
</tr>
<tr>
<td>Babb</td>
<td>2017</td>
<td>UK</td>
<td>Plans for Mobile</td>
<td>Partnered with Kontist Group to utilize white-label license and banking services infrastructure</td>
<td>Babbs app and prepaid Black card to facilitate savings account, money transfer, card transactions and currency exchange services</td>
<td>One of the first to create a bank based on permissioned Blockchain implementation of a distributed ledger using Ethereum Smart Contracts banking platform</td>
</tr>
</tbody>
</table>

70% of the term deposits are being bought online. It makes sense to be where your customers are - making digital-only banking an obvious channel. Nick Anthony, Head of digital-only banking, VTB Capital
With the increasing number of banks resorting to digital-only banking, it is valuable to see some of the benefits that they deliver:

- **Higher monetary benefits**: One of the foremost reasons that digital-only banking has gained traction is its low-cost operating model. Digital-only banks are in a better position to offer higher monetary benefits to the customer as they save on the physical infrastructure and operational costs of the bank. Hence, they often offer higher interest rates on savings, lower mortgage and loan rates, lower service charges and better services. According to statistics, digital-only banks offer a saving interest rate at least 80 basis points higher than traditional banks.

- **Better customer experience and loyalty**: Friction in the customer’s journey is reduced to a large extent, thus improving response time and efficiency. As a result, daily banking is simpler for the customer and for the bank. This has shown higher customer loyalty through higher NPS (Net Promoter Score), compared to traditional peers.

- **Financial inclusion**: Although this is more of an indirect benefit, digital-only banking can overcome many barriers for the un-banked population such as physical distance to the branch, lack of credit history and documentation, delay for services, cost and so on.

- **Product innovation**: Digital-only banks have more robust websites and mobile apps, offering advanced and innovative features that may not be found with traditional banks. Examples may be functional budgeting and forecasting tools, financial planning capabilities, social media interaction, investment analysis tools, loan calculators and equity trading platforms.

- **Mobility**: Being virtual, a customer can access their account and leverage the required services anywhere and anytime.

- **Targeted service offerings**: Most digital-only banks, specifically challenger banks, tend to focus on a specific set of services. This offers them more flexibility to innovate and update their offerings as well as tailor them as per customer needs.

While digital-only banking claims these benefits, some of the challenges of such models are:

- **Capital inadequacy for regulatory requirements**: Many of the major hurdles that most of the non-traditional players in digital-only banking face is inadequate capital to comply with regulatory requirements, especially in the mortgage market. A study by the Enterprise Research Centre (3) in UK found that about 25% of all challenger bank owners within the country felt that capital requirement to operate is their biggest barrier to growth, and the government must introduce reforms suitable for smaller firms. In fact, that could also be one of the reasons why challengers tend to focus on one area of service or customer group.

- **Gaining customer trust**: Being faceless makes it more difficult for a digital-only bank to gain a customer’s trust. Hence, it is entirely dependent on its product differentiation, and the efficiency of its channels, for customer acquisition. Moreover, it is well-known that it is hard to gain customer trust but easy to lose it for instance, with security issues.

- **Cybersecurity**: Another challenge posed by complete technological dependence and customer trust issues is the question of security and data breaches. This will become even more of a critical question with the expansion of open banking.

- **Technological dependence**: Being completely dependent on technology, a digital-only bank has no alternative channel of service in the event of service outages, technical issues, something that bank branches can cater to. Also, many disruptive models do not have technological facilities of their own such as ATMs. Hence, services such as cash withdrawal can also incur service charges.

- **Specific customer segment**: While digital-only banking has garnered immense appeal, most of its present customers either belong to the millennial group or certain geographies or demographics such as income etc., or those who multi-bank, with their secondary account in the digital-only bank.

- **Lack of personal relationship**: Presence of a branch helps to cater to non-standard customer requests at the bankers’ discretion, such as dismissal of service charges or an undeserved fee. The Wall Street Journal found that nearly 35% of consumers still value visiting a branch for their banking activities. However, with the presence of online or phone helpdesks and Chatbots, this looks like an achievable target.
Conclusion

Digital-only banking has come to occupy a strong foothold in Europe over the past decade, and as per research, is anticipated to grow even further in the coming years. While the key differentiator has been monetary incentives, the sheer number of players in this space means that banks will need to look beyond just price to establish themselves in the extremely competitive market. Here are some other factors that must be taken into account:

Robust business model:
Due to the evolving customers’ needs, banks need to rethink their business model. Adding a digital-only bank in their portfolio could help them capture value only if they find their unique selling points. As seen with YouGov stats, more than half of customers have multiple banks with the best offering for each product.

Technology and product innovations are the only ways to differ from competition. FinTech innovators can now be easily included in that banking offering thanks to Open Banking. Aside from this, regulatory reporting challenges such as PSD2, and GDPR, as well as geopolitical developments such as Brexit are further incentives for implementing more agile structures. Digital-only banks are designed to adapt smoothly to these challenges.

Banks-FinTechs partnerships:
Increasing collaboration between banks and FinTech companies is a win-win agreement. With this, FinTech players can leverage the infrastructure, technology, customers and financial backing of their bank partners. Larger banks that have struggled to adapt their systems and processes can also modernise their technology and offerings, while staying focused on their core services. Banks should leverage more such opportunities.

Several digital-only banking players are already present in Europe: some are created by traditional banks such as Rabobank International Direct Banking or FirstDirect; others are built from scratch such as N26. Both enjoy the same advantages such as higher monetary benefits, easier product innovations, mobility, better targeted services offerings, customer experience and loyalty and higher financial inclusion, as the customer segment targeted by a digital-only bank is often a niche that cannot be covered by a traditional bank.

We must bear in mind some challenges such as capital inadequacy for regulatory requirements, difficulties in gaining customer trust as there is a lack of personal relationships, the technological dependence and the cyber security threat. Nevertheless, the rise in popularity of digital-only banks means it has a large potential in capturing significant number of customers, especially in an era where bank margins are under pressure.
References


Case study

Public Cloud is the new way of managing IT for banks, and Sopra Banking software rapidly adopted to this trend and aligned its organization to gain new capabilities.”

Eelco Kaan, COO of Rabobank International Direct Banking

Rabobank is a Dutch multinational cooperative banking and financial services company headquartered in Utrecht, Netherlands. Founded in 1898 as a cooperative bank, Rabobank continues to focus on the food and agriculture financing as its primary business segment.

In 2002, Rabobank first launched Rabobank.be – an internet only savings bank – in order to get access to retail client assets, as well as experiment with new ways of banking. The bank was opened in a sandbox, in order to be agile and provide better customer experience. The digital-only banking channel enables Rabobank to reach retail clients.

The first implementation of the Digital-only Banking System – 14 years ago – was particularly challenging, as RaboDirect required a lot of customizations to achieve the right functionality. Despite the challenges, the implementation was a success, and as the system added more functionalities, Rabobank International Direct Banking also expanded its product portfolio.

In 2017, RaboDirect revisited its business strategy and architecture and decided to focus on being a savings only specialist with simple and transparent saving products and an outstanding customer experience. The Sopra Banking Software digital-only solution was again chosen, but this time as a out-of-the-box solution. The choice was made because its wide functionality, a high capability to execute in a short span, with implementation experience in the European regulatory environment, with a product as standard as possible, and of course, a low Total Cost of Ownership.

Using a standard product ensures high quality of performance as well as support. In addition, this implementation enables single setup for multiple countries. This has resulted in significant savings for Rabobank International Direct Banking in terms of customization costs. In addition, the digital-only banking solution could easily integrate with other front office suppliers, which allows RaboDirect to provide a superior user experience (thanks to a two-tier IT model).

In addition to the renewal of its digital-only banks, Rabobank International Direct Banking also selected Sopra Steria Group to implement a public cloud-based bank. Being an industry first, this implementation was new for both the RaboDirect as well as the Sopra Banking Software team and posed several challenges. Despite the initial challenges, by being very responsive and re-aligning the organisation in order to gain new capabilities, Sopra Banking Software was able to get the project back on track.

KEY BENEFITS

1. Rabobank International Direct Banking achieved a significant reduction in cost by moving its infrastructure to cloud, using an out-of-the-box platform, and using Sopra Banking solution for Digital-only Banks in the multi-country mode.

2. The use of 2-tier IT enables RaboDirect to make faster improvements in UI and UX, and implement new features independently of the updates to the core platform.
Evi is the digital-only banking arm of Van Lanschot Private Banking and was launched in 2013. Founded in 1737, Van Lanschot is the oldest independent bank in the Netherlands and its primary customer segment consists of High Net Worth Individuals (HNWIs) with over EUR 500,000 in investible assets. EVI was launched in 2014, with the aim to extend its services to more customers, with a minimum investment requirement of just EUR 1,000.

Since private banks operate in a low volume of customers, the digital-only bank channel was the best channel for EVI to scale their operations and make their services available to the new customer segment, without making significant investments in real estate. In order to cater to the large volume of new customers, EVI decided to use a robo-advisor in a hybrid model – the robo-advisor helps the customer to define his personal investment profile whereby his investment will be managed by the same human experts of the private bank. The client enrolment process is 100% online. This allows EVI to extend the expertise of a private bank to those who may not have HNWI levels of wealth.

In order to launch a digital-only bank, EVI was looking for a supplier who could provide end-to-end services – system implementation, and the relevant savings and investment products, and Sopra Banking Software fit the bill. Since digital-only banking was in a very nascent stage 4 years ago, Sopra Banking Software had to work with EVI to build special capabilities for this implementation. The initial implementation was completed satisfactorily within the planned 6 months. In 2016, EVI became the first player in the region implementing a SaaS-based solution, and also chose Sopra Banking Software for the implementation.

**KEY BENEFITS**

1. The digital-only banking channel has led to a significant increase in customer interest, as well as new accounts for EVI. This channel allows access to the expertise of Van Lanschot for customers who could not have otherwise qualified for their service as a private bank.

2. The robo-advisor solution allows customers to interact with the bank 24*7, providing instant service in real-time, and at the same time allows human investment advisors to spend more time providing value to clients (rather than answering basic queries and executing simple order requests).

3. The digital-only bank channel allows customers to have a full view of their accounts and full transparency at all times.

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A digital-only banking channel provides customers access to expertise of a private bank at much lower costs, while providing full transparency.

Michel Schram, Head of EVI
With 4,000 experts, a pro forma turnover 2017 of €402.2 million and one of the deepest, broadest portfolios of software and services, Sopra Banking Software is a trusted, long-term partner of over 800 banks in more than 70 countries. Sopra Banking Software has an unequalled ability to address the requirements for banks and financial institutions of any size and scope, allowing them to innovate and expand their services. Sopra Banking Software is a subsidiary of the Sopra Steria Group, a world leader in digital transformation, with nearly 42,000 employees. In 2017, Sopra Steria achieved a pro forma turnover of more than €3.8 billion. For more information follow us on twitter @SopraBanking or visit www.soprabanking.com