

The Advent of Neo-Banks in the U.S



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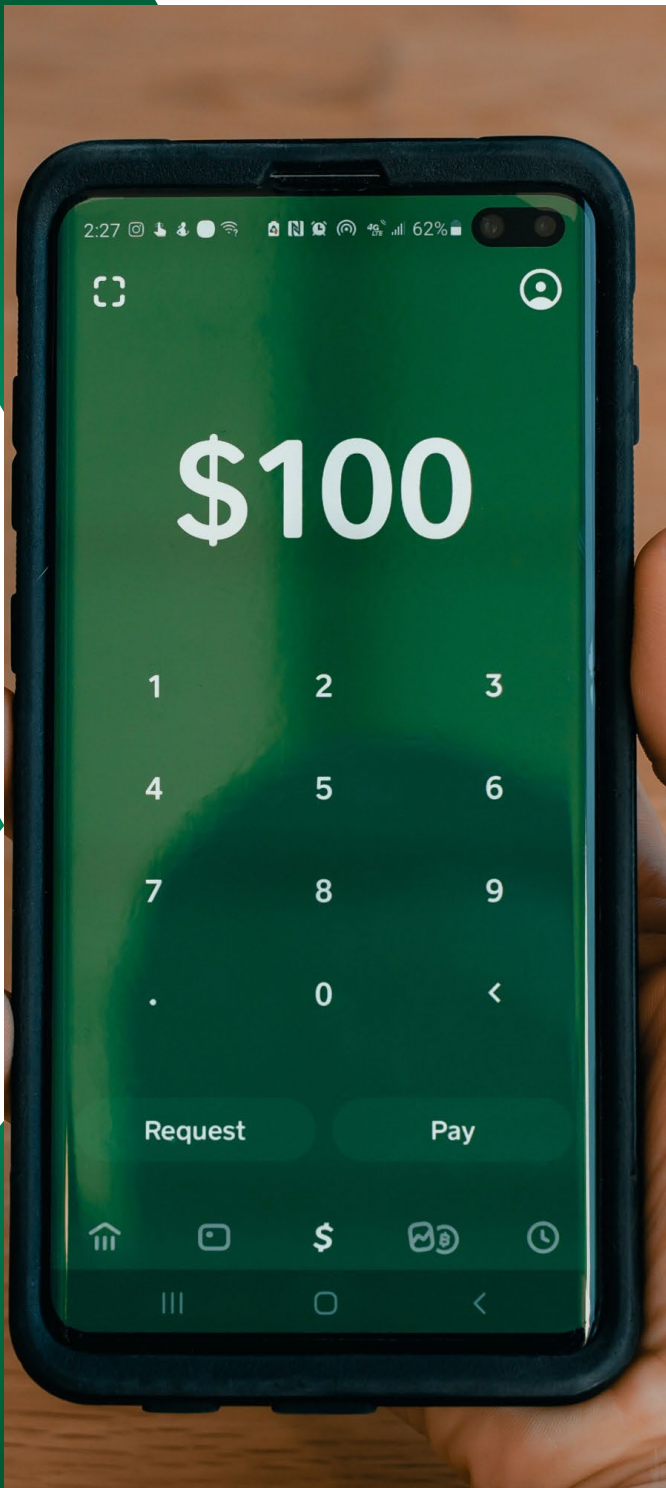
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Introduction

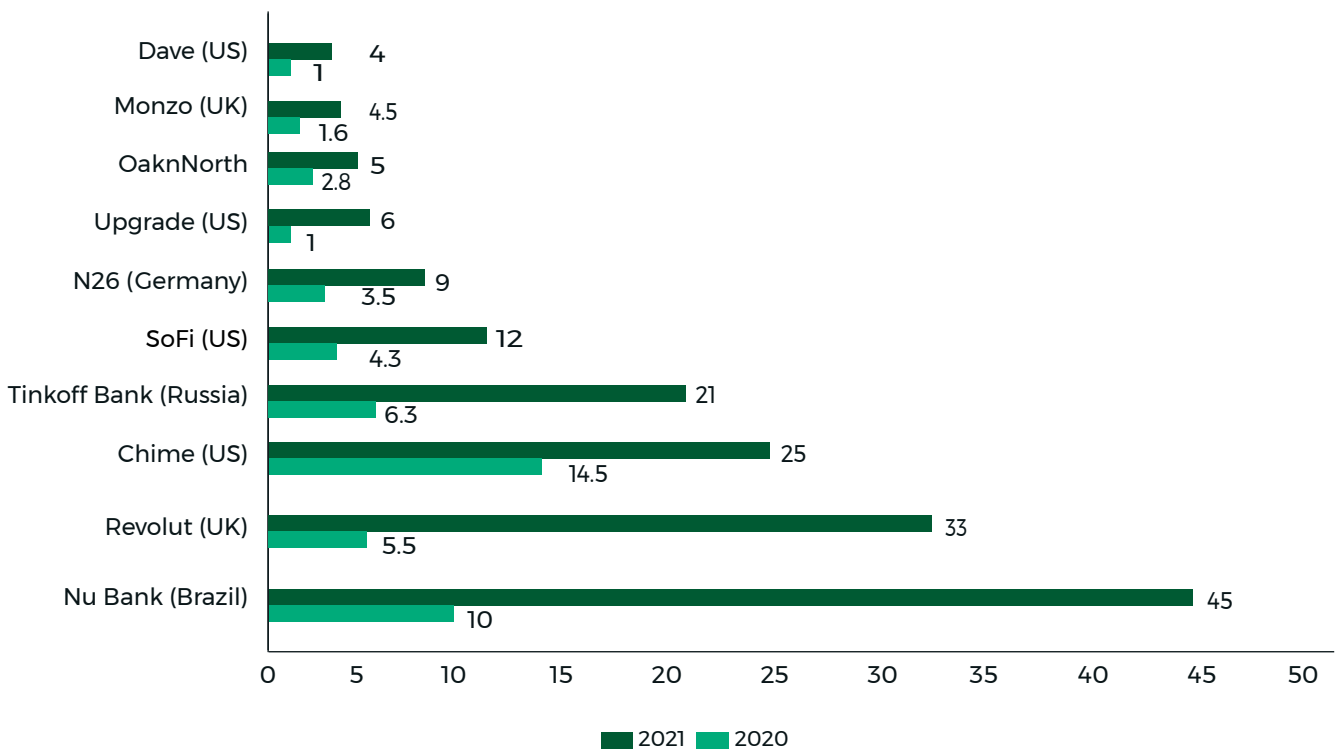
According to the Federal Deposit Insurance (FDIC) Survey of Household Use of Banking and Financial Services, an estimated 5.4% of U.S. households (approximately 7.1 million) were "unbanked" in 2019, meaning that no one in the household had a checking or savings account at a bank or credit union (bank). Conversely, 94.6% of U.S. households (approximately 124.2 million) were "banked" in 2019, meaning that at least one household member had a checking or savings account. These figures suggest that there is an opportunity for banking service providers to find new customers. And this large pool of unbanked population is one of the key reasons that attracted the advent of neo and challenger banks.



What Is Neo-Bank?

A neo-bank is a mobile, online, and tech-based bank offering financial and digital services and has no physical branches. These banks provide services like lending, investments and savings accounts, and credit cards like a traditional bank; however, they operate entirely online. Nubank in Brazil is currently the largest Neo-Banks by value, followed by Revolut of the U.K. and Chime of the U.S. The chart hereunder lists the value of the top 10 Neo-Banks worldwide in 2020 and 2021. It demonstrates the robust growth trajectory of Neo-Banks globally.

Figure 1: Top 10 most valued independent Neo-Banks in the world



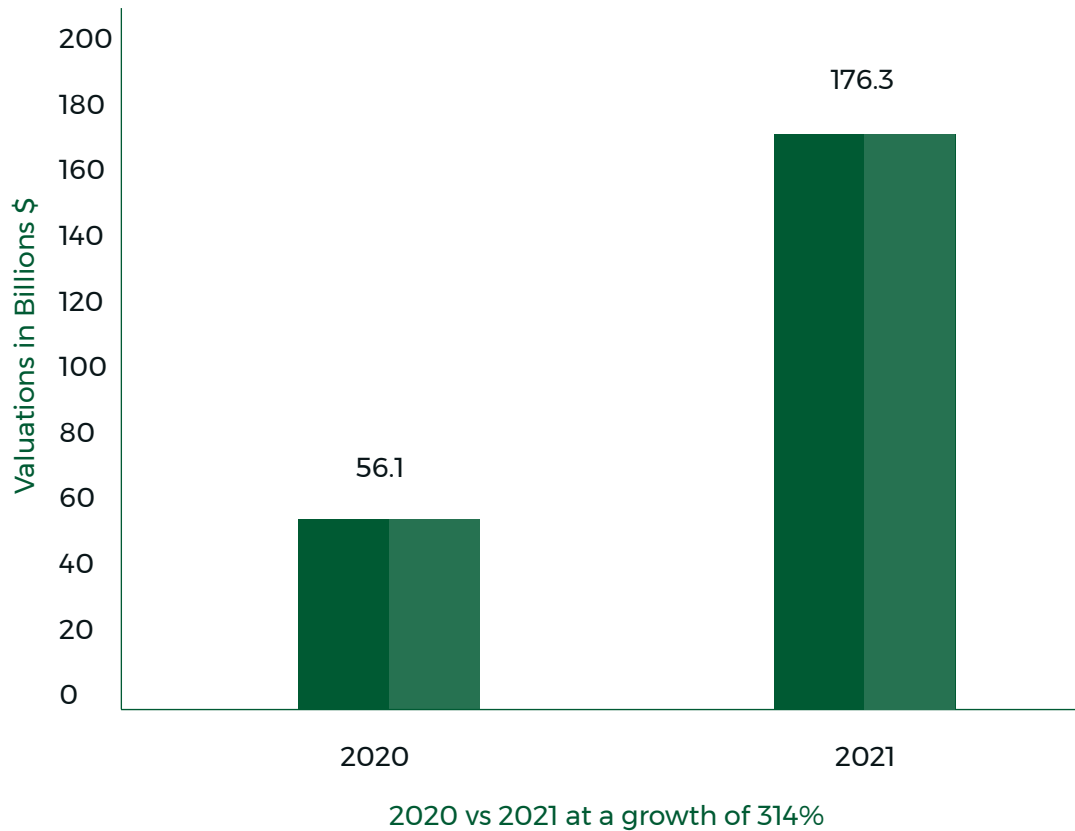
Source: Whitesight.net

The rise of Neo-Banks and how is the U.S. faring?

Valuation analysis of 15 of the world's largest Neo-Banks indicates that in 2021, the valuation of these top placeholders increased by 314% compared to 2020. The top four Neo-Banks in terms of valuation are:

1. Chime: US \$25 Billion
2. Sofi: US \$12 Billion
3. Upgrade: US \$6 Billion
4. Dave: US \$ 4 Billion

Figure 2: Valuation of top 15 Neo-Banks 2020 vs 2021

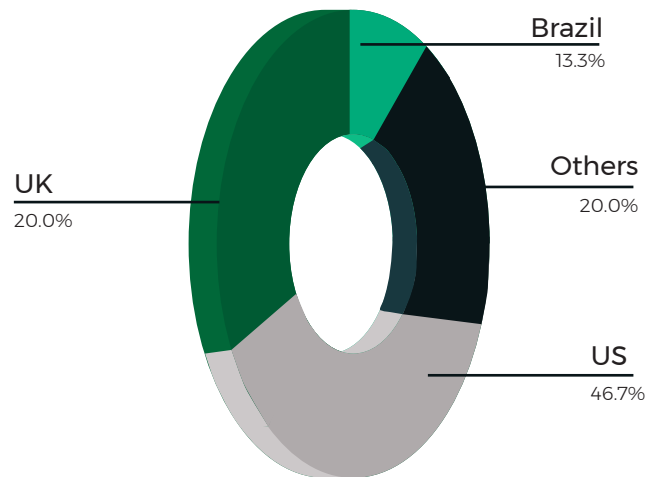


Source: Whitesight.net

Where do the 15 most valued Neo-Banks originate from?

The U.S. neo-bank ecosystem competes well with its global peers; seven out of the top fifteen Neo-Banks worldwide are headquartered in the U.S. The data hereunder showcases the country of origin of the fifteen most valued Neo-Banks. And the U.S. commands a share of 46.7% in this league.

Figure 3: Where do the 15 most valued Neo-Banks originate from?

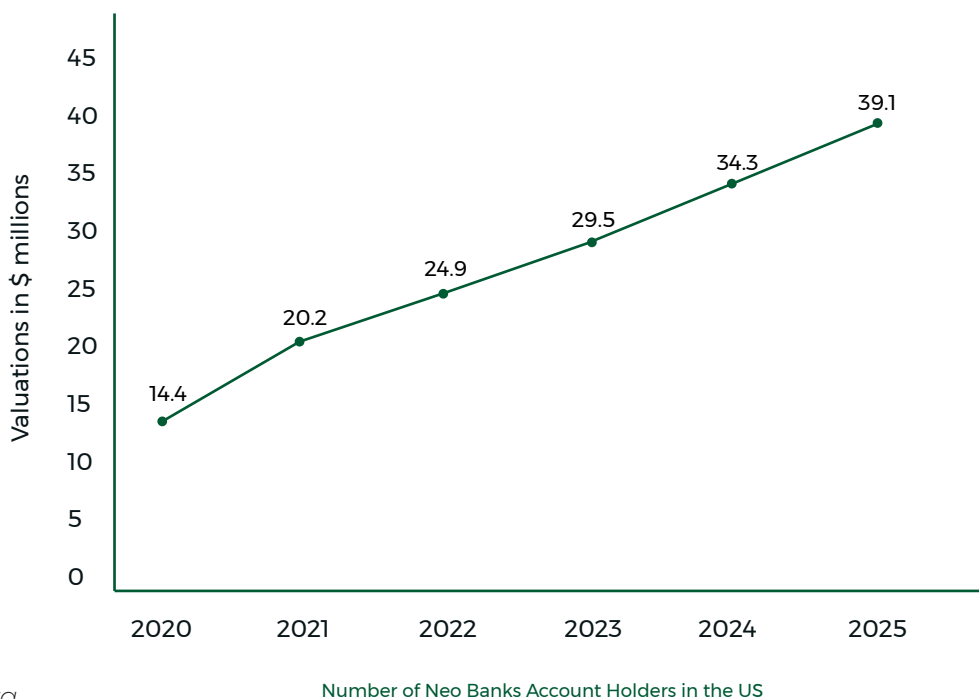


Source: Whitesight.net

Is Neo-Banking gaining traction amongst US citizens?

US citizens have taken a keen interest in services provided by Neo-Banks. The user base was 5.6% of the population and is expected to grow to 14% of the population in 2025. It has witnessed and is expected to grow at a healthy rate.

Figure 4: The number of neo-bank users from 2020 to 2025

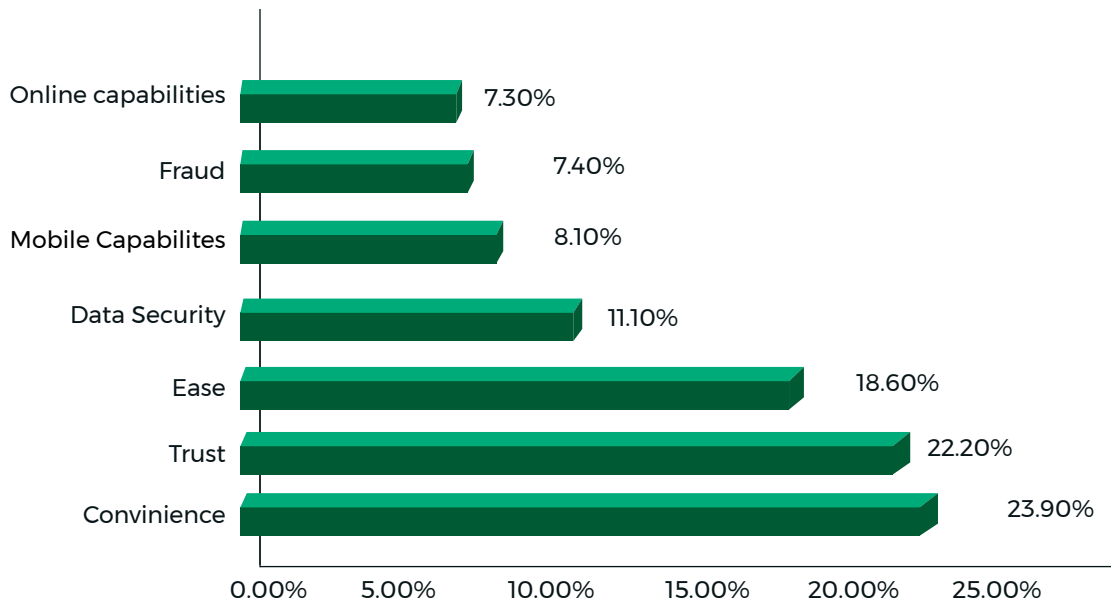


Source: Statista

What is fuelling this growth?

The digital-only operations of Neo-Banks are a significant attraction for users to gravitate towards them. According to a report by Pymnts.com, 24% of consumers stated that convenience is their most important reason for using digital-only banking services. Wherein 22. % and 16.6% categorized trust and ease as their reason for using digital-only banking. The chart here under demonstrates the most important reasons people cite for using digital-only banking services.

Figure 5: Why consumers use digital-only banking services

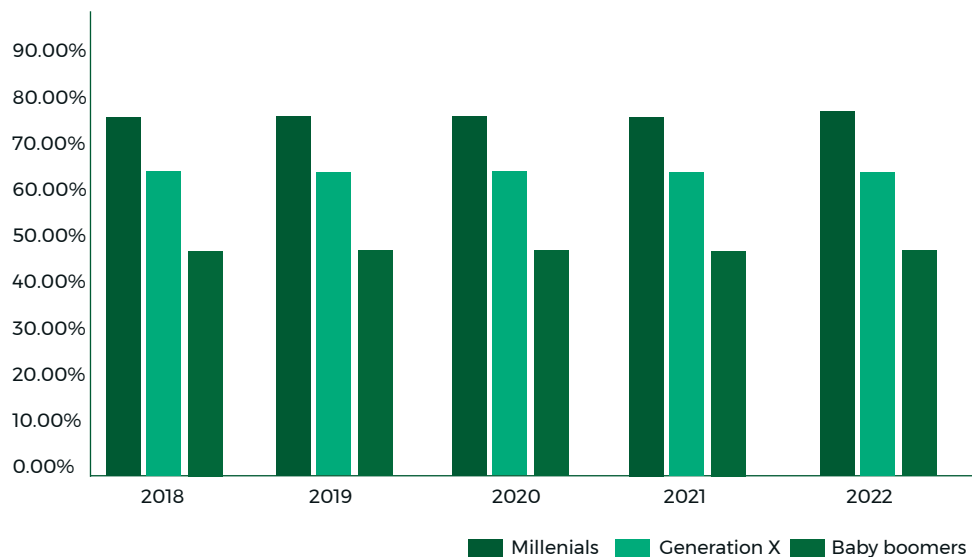


Source: Pymnts

Digital banking usage in the US by generation

A recent survey in the US suggests an increase in the average user base of digital banking across generations. Especially millennials and generation X have demonstrated a steady increase in the adaption of digital banking methods.

Figure 6: Share of population using digital banking in the US by generation



Source: Accenture & eMarkter (2018)

How are Neo-Banks overcoming this challenge?

The FDIC hasn't issued new banking licenses since 2008, and the Community Reinvestment Act requires that banks have branches. And Neo-Banks' business model doesn't feature any physical branch banking. Until the Office of the Comptroller of Currency (OCC) Fintech Charter comes out; there isn't a regulatory framework for challenger banks in the U.S.

Under OCC proposals, a new fintech charter may be introduced in the U.S to create a more precise regulatory environment for challenger banks. The proposed Fintech Charter has faced legal obstacles and questions about its constitutionality; however, the OCC continues to explore its potential.

In 2016, the OCC released a white paper stating that it has formulated eight principles to guide the development of its framework for understanding and evaluating innovative products, services, and processes that OCC-regulated banks may offer or perform. These principles call for the OCC to:

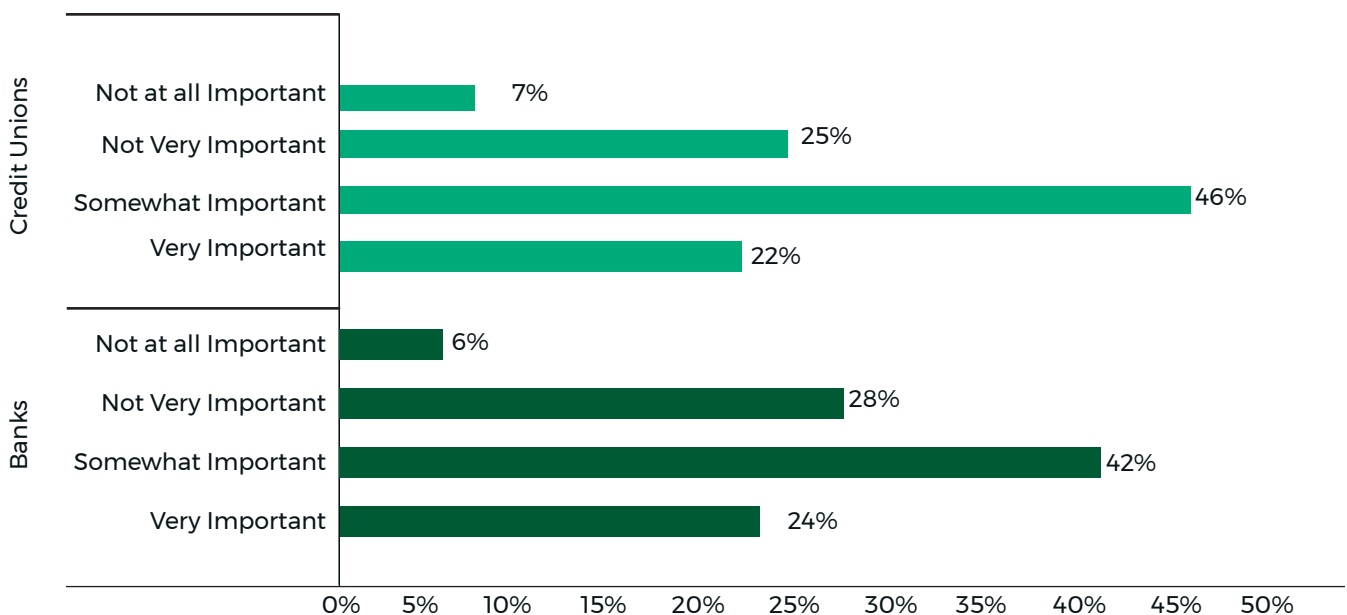
1. Support responsible innovation.
2. Foster an internal culture receptive to responsible innovation.
3. Leverage agency experience and expertise.
4. Encourage responsible innovation that provides fair access to financial services and fair treatment of consumers.

5. Further safe and sound operations through effective risk management.
6. Encourage banks of all sizes to integrate responsible innovation into their strategic planning.
7. Promote ongoing dialogue through formal outreach.
8. Collaborate with other regulators.

How are Neo-Banks overcoming this challenge?

To overcome this challenge, Neo-Banks are partnering with scheduled banks through affiliation with an insured bank or directly insured by becoming an insured bank subsidiary. This affiliation empowers Neo-Banks to offer digital banking services to their customers in niche areas that the larger banks usually cannot serve. Neo-Banks are fundamentally fintech organizations, and many banks and credit union executives opine that partnerships with such companies are very to somewhat important. According to a survey conducted in 2020 amongst executives at banks and credit unions in the United States, 14% responded that they view fintech-driven entities such as Neo and banks as an upcoming threat in the coming decade. However, a subsequent survey reported that this number rose to 28%. The chart hereunder provides a detailed break-up of such executive opinion toward fintech partnerships based on a survey conducted in 2021.

Figure 7: Importance of fintech partnerships according to bank & credit union experts

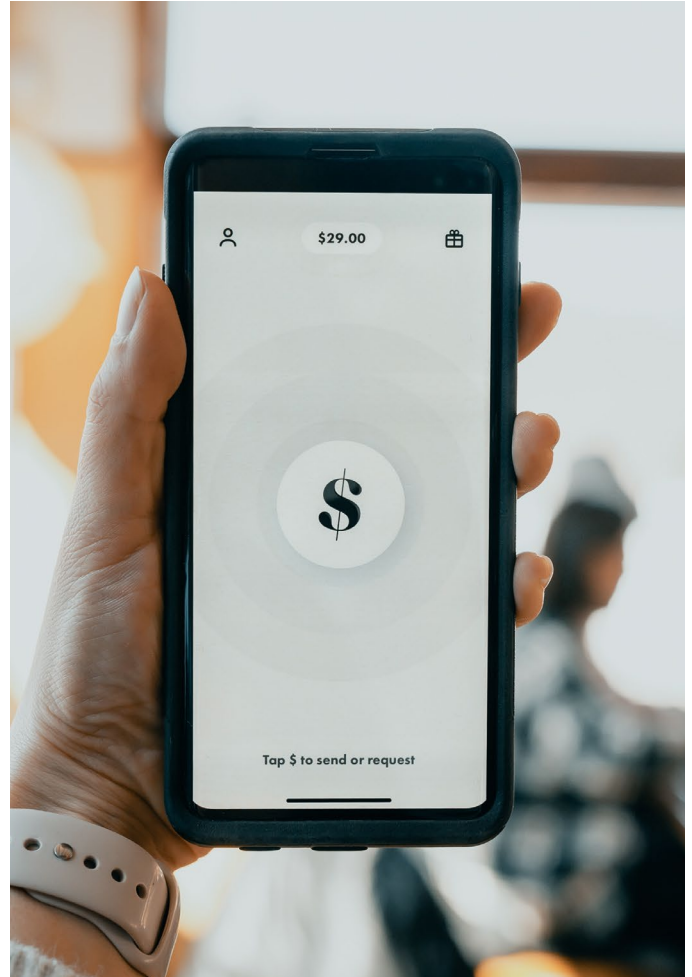


Source: Cornerstone Advisors 2021

Conclusion

Neo-Banks are riding on technology and gaining traction with the younger generation; however, they have challenges. According to a survey, 25% responded that they would not use digital-only banking services since they were concerned about their data security, and another 22% were concerned about fraud.

Furthermore, Neo-Banks is awaiting the OCC (Office of the Comptroller of the Currency) charter to establish the ground rules and regulatory framework. However, experts recommend that Neo-Banks maintain compliance with anti-money laundering regulations and counter-finance of terrorism. Such actions will benefit their operations in the long run and help them make a solid case for securing the licenses.



Another challenge Neo-Banks face is getting eroded by the digital transformation of regular banks, which might extend their reach and eradicate the need for Neo-Banks in society. Due to a lack of regulation and Neo-Banks licensing clarity, most Neo-Banks have partnered with regulated banks or are becoming their subsidiary. However, Neo-Banks thrive on certain advantages and have the benefits of agile and scalable technology and command a niche segment hitherto ignored by regular banks.

About Agpaytech

Agpaytech Ltd. is a company pioneering in the Fintech Space with a focused approach to building robust technologies for eCommerce Card Processing Solutions for Payment Service Providers (PSPs). Additionally, we provide Compliance and Regulatory Umbrella, Remittance-as-a-Service, White-Label solutions, Foreign Exchange, Cross Border Payments, and digital currency technology. We have partnered with multiple banks, non-banking financial institutions, and corporate organizations to create a solid service delivery model for them and their customers to ease their international remittances and payments concerns.
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