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Summary

- Digital transformation has become essential for banks to future-proof their business model and improve the customer and employee experience, operational efficiency, and business economics
- The rise of digital-native Challenger Banks is causing a global disruption as they traverse borders and disrupt the status quo in most mature and emerging markets
- Analyzing over 100 Digital Challenger Banks globally, we have identified 6 shared characteristics that unite their DNA: digitally native customers, evolving product offerings with well-being at the center offered through scalable channels, lifestyle marketing and branding emphasizing the emotional experience for customers, rapid growth cycles, top talent models and reduced regulatory friction
- The US banking market has been a noticeable laggard in digital adoption and is now ripe for the scale of disruption seen in other markets as retail customer expectations are evolving at an unprecedented pace, further fueled by the forced digital adoption driven by the emergence of COVID
- Incumbent US banks must look at ways to evolve their Digital DNA – at a minimum they need to jump start conversations on growth strategies, operating model redesign and reprioritization of the transformation agenda

I. A global phenomenon

In the modern era, the way we communicate, do business, and live is radically different than a mere decade ago. We are living in an ever-changing world, where rapid advancements in technology are revolutionizing products and services, requiring flexible business models that can deliver them. In parallel, customer preferences are evolving to a digital first mind-set and customer expectations are anchored on seamless, real-time, integrated, and personalized experiences.

The Financial Services (FS) industry is not immune to these headwinds and a new wave of competitors are emerging. **Digitally Native ‘Challenger Banks’** are unpacking the banking value chain and are redefining the boundaries of the industry. These new competitors are growing rapidly and are stealing market share from incumbent banks.

These ‘Challenger Banks’ are branchless, digital-native banks that intend to compete head-on with incumbents. While they start with a simple product offering, their long-term ambition is often centered in a more complete suite of financial products and services. The need for significant R&D spend means these Challenger Banks often emphasize growth over profitability in their early years and rely heavily on external funding to fund their growth ambition.

With a digitally focused, seamless customer experience, and a value proposition that resonates with a specific target segment, Challenger Banks have been able to acquire a significant customer base around the world. Revolut, a digital native offering a suite of banking products, did not exist in 2015 but now has over 8 million customers and is expanding into the US and Australia.¹ Founded in 2015, Monzo today has more than 4 million customers in the UK—a market with only ~70 million accounts—giving it a 4% UK market share in terms of accounts.² Together, Monzo and other UK Challengers such as Starling and Tide, now hold a market share of more than 14% for primary accounts being switched.³ In Brazil, NuBank, an app-only bank for the previously unbanked or underbanked is now the largest digital challenger in the world with over 15 million unique customers after growing 200% YoY in 2019.⁴

¹ <https://www.revolut.com/en-US>; <https://www.bbc.com/news/business-47768661>

² <https://monzo.com/>; <https://www.forbes.com/companies/monzo/#394330fe41e3>

³ Source: CASS switching service, 2020, <https://www.bacs.co.uk/>

⁴ <https://nubank.com.br/en/>; <https://www.reuters.com/article/us-nubank-brazil-growth/brazilian-fintech-nubank-has-grown-to-15-million-users-ceo-idUSKBN1WQ26C>

The US is one of the few developed markets with has not yet seen widespread disruption by true Challenger Banks. However, the number of Challengers, both domestic and foreign-owned imports is on the rise. This begs the question—is the US about to follow Europe, Asia, and LATAM in seeing a wave of disruption across banking driven by the explosion of Challenger Banks?

Deloitte has analyzed over 100 Challenger Banks globally and, whilst each value proposition is not quite the same, we have identified a set of fundamental characteristics that make up their DNA enabling them to successfully disrupt the banking status quo in around the globe.



I. DNA

To understand the long-term disruption these Digital Challengers are likely to drive in the US, we first need to unpack what has made them so successfully disruptive elsewhere.

Customers

Challenger Banks value propositions place the customer at their core and tend to target a specific customer segment—digitally native, unsatisfied, underbanked, or unbanked, and often with simple banking needs. In short, these are the customers incumbents may have neglected as they offer limited immediate earnings potential and limited alternative choices available. These customers share similar expectations in what they seek: transparency (e.g., no hidden or excessive fees); ease (no lengthy, paper-based documentation, endless branch or phone queues); and accessibility (banking services wherever, whenever) in their experience.

In Latin America, many consumers are underbanked or unbanked by incumbents. For example, about 80% of Brazilians have smartphones but only 70% have a bank account.⁵ Similarly, based on a 2018 study published by The World Bank, only 37% of Mexican adult consumers are banked⁶, compared to the 66% of the population that used the internet regularly in 2018.⁷ Often these customers lack the documentation required by incumbents to enter the formal banking system. These digitally-savvy but underserved customers presented a huge opportunity for challengers with their mobile-first banking services and innovative approaches to client onboarding.

European mobile adoption often exceeds 100% (multiple devices per individual) and penetration of banking services is much higher than in Latin America but the friction in account opening and servicing journeys meant that needs of digital natives were being underserved by incumbent banks.⁸ Many incumbent banks still require human interactions and cumbersome physical forms and documents to process unsecured consumer or small business loans while non-bank fintech's have been offering fully digital product journeys for nearly a decade. In addition, excessive foreign transaction fees associated with debit cards did not sit well with customers that frequently travel across Europe. Major European banks typically charge a currency conversion fee for foreign currency transactions, ranging from 1% to 3% of the purchase amount (1.5% on average) in addition to a fixed fee per foreign country transaction. Challenger Banks, such as N26 and Monzo, on the other hand can offer a zero FX fee for card spend regardless of currency as they do not currently have the same margin pressures incumbents face.

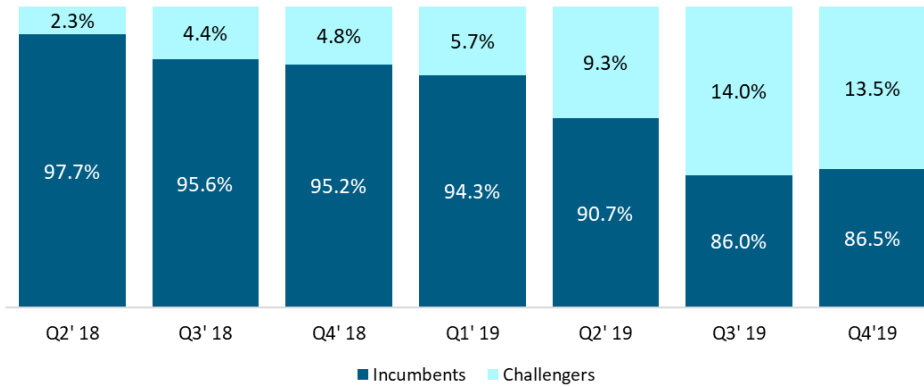
⁵ <https://globalfindex.worldbank.org/>

⁶ <https://openknowledge.worldbank.org/bitstream/handle/10986/29654/LDB-FinInclusion2018.pdf?sequence=1&isAllowed=y>

⁷ <https://www.statista.com/statistics/209112/number-of-internet-users-per-100-inhabitants-in-mexico-since-2000/>

⁸ [https://data.worldbank.org/indicator/IT.CEL.SETS.P2?end=2018&most recent year desc=false&start=2018&view=map](https://data.worldbank.org/indicator/IT.CEL.SETS.P2?end=2018&most%20recent%20year%20desc=false&start=2018&view=map)

UK CASS Switching Service Statistics, 2019⁹



Sample of c. 4% of total annual account flow in the UK⁹

While many Challengers are still far from having average balances, revenue, or profits per customer similar to those of incumbent banks, they have set a great example of how a value proposition targeted at unmet or underserved needs of customers can drive customer acquisition. Incumbents need to ask themselves if they have a similarly good understanding of their customers and if their value proposition is truly meeting them.

Large incumbents undergoing complex multi-year technology transformation efforts may need to reprioritize where to focus in order to ensure the features and services customers value the most are expedited into production.

Solely focusing on existing profitable customers may not be enough to futureproof long term revenue and portfolio growth. Knowing who the lucrative customers of tomorrow are today, what they value, and how you can grow together through their financial lifespan is imperative to win in an increasingly congested market.

Key actions for incumbents

- Voice of the customer research, focus groups to understand needs and preferences
- Customer segmentation and persona definition for valuable target segments
- Experience and proposition design to emotionally connect with customers

Product & channel

By focusing on these unserved or unsatisfied needs, Challengers developed a product offering and channel experience that targeted the points of the value chain where incumbents' weaknesses were most exposed and often not easy to fix. Most commonly, this was low satisfaction with customer service levels, broken digital account opening and servicing journeys, and complex product terms with various layers of hidden add-on fees.

By targeting these known friction points, challengers were able to create digital-first, mobile centric experience at a 75% lower acquisition cost.⁹

It is important to note that overall, the core financial products offered by challengers are not materially different to those offered by incumbents - it is the product terms and distribution that challengers are experimenting with. Challenger Banks around the globe often followed a similar approach and prioritized offering a simple, transparent product that satisfies the needs of their core customer segments over launching multiple products or product variations at once. At launch, focus was also placed on a seamless user experience which felt different to incumbents. For example, opening an account with Monzo in the UK in 2018 and N26 in the US in 2019 took less than 5 minutes.¹⁰ Compare that to opening an account with an incumbent bank in the US where scheduled in-branch meetings can take over an hour with approvals often taking multiple days.¹¹ While incumbents are unlikely to achieve digital parity overnight, they have the opportunity (and capabilities) to explore simpler and more transparent product offerings as championed by Challengers.

Open Banking and the trend towards a de-layering of the banking value chain is also a key catalyst for the rise of Challengers. Customers no longer expect to acquire all their financial products from a single institution and are increasingly shopping around for individual products.

Building on their success, challengers are continuously evolving their value proposition to include more complex products (such as overdrafts or credit cards). They are doing so in close collaboration with their customers. A good example is Monzo which in 2017 asked its community of customers to vote on fees for ATM withdrawals which subsequently led Monzo to introduce a fee for cash withdrawals above GBP200/month—still significantly cheaper than incumbents.¹² Fidor Bank, a German challenger, takes co-creation a step further by *'discussing the future interest rates or naming the current account card that the bank will use, are just some of the options we've explored.'* (Fidor Bank 2019).¹³ Revolut launched the "RevRally"—an event held periodically in different cities with free food and drinks and senior leadership presentations, with the intent to engage brand loyalists and spread the word about their plans.¹⁴

While the starting proposition for challengers has often been similar, the evolution of their value proposition is often unique. Revolut focused on adding stockbroking, business banking, cryptocurrency, and subscription tiers, NuBank moved into credit cards and personal loans, and Monzo decided to follow a number of other Challenger Banks that are expanding into business banking services, specifically targeting Small-to-Medium Enterprises (SMEs).¹⁵ This sector offers a plethora of other opportunities to combine services and product beyond banking such as tax, accounting, supply chain and inventory management as well as the potential for advanced analytics services.

However, Challenger Banks do not currently need to worry about consistency across an omni-channel experience, as they continue to myopically focus their channel experience

Source: CASS switching service, 2020, <https://www.bacs.co.uk/>

¹⁰ <https://www.economist.com/special-report/2019/05/02/neobanks-are-changing-britains-banking-landscape>

¹¹ <https://monzo.com/blog/2019/09/18/when-did-i-open-my-account>; <https://get.n26.com/?ch=homepage>

¹² <https://www.moneymax.ph/credit-card/articles/citibank-credit-card-application-guide/>

¹³ <https://monzo.com/blog/2017/09/13/atm-fees-abroad>

¹⁴ <https://www.fidor.com/work/fidor-bank-2>

¹⁵ <https://www.ft.com/content/7fa2a8ea-8e66-11ea-a8ec-961a33ba80aa>

¹⁵ <https://www.revolut.com/en-US/>; <https://nubank.com.br/en/>; <https://monzo.com/>

on frictionless end to end digital journeys via smartphones. Rapidly evolving and maturing this channel to handle all journeys and products ensures a constant and robust end user experience.

In the past the shortcomings of many products and channels were protected by the inconvenience and effort for customers to switch. But as services offered by challengers are only one download away, is this still a valid defense for incumbents?

Key actions for incumbents

- Product portfolio optimization and simplification to improve Customer fit
- Optimize the physical distribution network (location and format) to reduce cost/increase productivity
- Define and deliver a consistent experience across channels
- Build the distribution ecosystem of the future

Growth cycles

In building their value propositions, Challengers tend to follow a recurring growth cycle. Starting with an initial value proposition, Challengers gradually expand their customer portfolio as they reach new segments and gain a stronger reputation. This allows them to point to a rapidly growing customer base when raising capital for their next development cycle. This cycle repeats itself as challengers acquire more customers in and across segments and regions and launch more products and services with a goal to eventually become self-funding as their product line-up approaches maturity.

The majority of Digital Challengers have not yet reached a self-sustaining business model as they prioritize growth over profitability. On average 70% of accounts are not used on a monthly basis and the average blended balance for deposit accounts is often low (\$250-350USD).¹⁶ Thus, Challengers often rely on continuous capital raises to fund their business expansion and their huge valuations are driven by investors who believe these Challenger Banks will be able to monetize their ever-growing customer bases in the future.

Given the infancy of many of these Challengers, assessing whether these growth strategies will drive long term success and profitability may be premature. However, recent steps taken by some of the larger and mature challengers indicates moves in the right direction. In an aim to add in some predictability and stability into financial forecasting, Revolut has introduced tiered subscription models for its accounts ranging from a free basic account to the “Metal” Cash back Concierge account priced at ~\$16 a month.¹⁷ This model could prove to be especially profitable at scale or in the Small Business Banking segment especially as different services and tiers are added. Monzo and N26 have also adopted similar subscription-based strategies whilst given new product lines and a steady uptick in new customers, and, in March 2020, the CEO of London based Starling bank, Anne Boden stated that the bank was on track for full profitability in 2021 with an IPO to follow in 2022.¹⁸

¹⁶ Deloitte Analysis

¹⁷ <https://www.revolut.com/our-pricing-plans>

¹⁸ <https://www.finextra.com/newsarticle/35027/starling-eyes-ipo-and-forecasts-break-even-by-year-end>

However, with rapid growth and expansion comes the pressure of profitability. Currently most of a challenger banks revenue mix see's 80% coming from non-interest income products and services and the remainder from interest income products. This is reversed for Incumbents.

Challenger banks will need to balance product mix, scaling operating costs as they seek to drive to year over year profitability.

Key actions for incumbents

- Instill an agile test and learn approach to innovation and growth
- Setup a market intelligence capability to continuously monitor challenger proposition and revenue model innovation to inform in-house value proposition
- Scan market for challengers that present attractive M&A opportunities due to failed growth cycle

Brand & marketing

Another key ingredient for the success of Challenger Banks is their approach to branding and marketing. Challengers are positioning themselves as something more than just a bank. They implement high virality marketing strategies to build customer relationships and brand equity through a wide mix of non-traditional marketing channels for a bank such as word-of-mouth, influencers and social media. This has allowed Challenger Banks to build strong emotional ties with their customers—something that incumbent banks have tried and failed to do for a long time. For example, Starling Bank and Monzo play on the delight customers will feel with the bank's frictionless experiences. In 2020 Xinja, an Australian Challenger targeted specifically at digital natives launched a campaign encouraging its target customers to "Ditch Dad Banking". The advertisement suggested Xinja as an option for its audience to break free of the Boomer-era bank, highlighting the "dad joke" trope through photos of middle-aged men dancing awkwardly in argyle sweaters, vacationing in speedos and fanny packs, and posing in white underwear as the target market for incumbents. While undoubtedly tongue-in-cheek and provocative, the campaign coincided with the bank taking \$100 Million AUD in deposits and onboarding 15,000 new customers in under three weeks.¹⁹

Each successful challenger has built an emotional brand affinity beyond just their strong product mix. Nigeria's ALAT bank released a video featuring vibrantly dressed young dancers to reinforce their brand as a fresh, cool bank—a far cry from the conservative advertising that usually associated with incumbents.

Challengers Banks are typically known for emotive branding and with many positioning themselves as technology companies serving the financial sector enables them to be accessible and symbiotic with consumers' routines and favorite apps. Their advertisements are typically loud and bright, and their designs are visually appealing, branding themselves as digital-first, customer-centric, and data-driven, alternative to incumbents, with the implicit message that banking can be cool and easy. Challenger

¹⁹ <https://xinja.com.au/news/2020/ditch-dad-banking/>; <https://xinja.com.au/media/2020/media-release-xinja-launches-stash/>

Banks' physical cards typically break with the traditional colors and style and come in bright colors and form a core part of their brand identify.

Monzo leveraged a social media platform to rapidly create brand awareness years before they were awarded a UK banking licenses. This effort was part of a wider marketing strategy that allowed Monzo to not only break a crowdfunding record in 2016 by raising £1M in 96 seconds but also to double its valuation to \$2.5B USD in just eight months by raising \$144M USD.²⁰ Challenger Banks around the globe share these innovative approaches to branding and marketing as part of their overall growth strategy. As the younger, digitally native demographic begins to enter and dominate the marketplace, these new approaches to engaging and acquiring new customers will be critical to future success.

In this current climate new and existing brands, are especially fragile and can only take a small incident to cause reputational damage.

Thus, when considering their own Digital agendas incumbents must consider brand and the associated marketing as key competitive levers and a means of (re)-connecting with existing and potential customers.

Key actions for incumbents

- Evaluate fit and effectiveness of existing marketing strategies for targeted segments
- Conceptualize and test new brand and marketing positioning with targeted segment(s)
- Revisit brand and marketing Strategy to identify opportunities to improve brand positioning with customers (drawing on challenger playbooks as required)

Platforms & partnerships

Digital is at the core of Challenger Banks' DNA. They rapidly 'grew up' and matured in a world where ecosystems and partnership are the norm, not the exception. Enabled by a new generation of APIs, new entrants no longer need the time and capital to build banking services and products in-house—instead they can leverage Banking-as-a-Service platforms that can be seamlessly sourced and connected to the core banking platform with limited upfront investment. While Challenger Banks are nimble, traditional banks have long struggled with investing in disruptive technology. While IT spending has increased to \$104B in 2018 according to Celent, roughly 73% goes to maintenance of legacy infrastructure.²¹

Being digital-only has allowed challengers to develop fluid and intuitive user experiences not impacted and constrained by technical debt born by many Incumbents due to legacy systems and infrastructure.

Many incumbent banks are investing heavily in overhauling their technology ecosystems and in digitizing the banking value chain. In 2019 over \$65B was spent on transformation

²⁰ <https://monzo.com/blog/2016/03/03/crowdfunded>

²¹ <https://www.celent.com/insights/929209647>

across US banks however, given size and complexity, the benefits of these efforts will not be realized overnight.²²

Today's technical landscape has significantly reduced the barriers to entry as new entrants no longer require the capital to build the banking architecture, reducing the overall risk for investors. Being native to cloud and exponential technologies has also allowed challengers to operate and reduce the cost to serve significantly below that of incumbents. The question that remains to be answered is whether Challenger Banks can maintain their cost:income advantage as they expand.

Key actions for incumbents

- Revisit Digital transformation agendas and identify the priority technology and features required in the short term to help ensure digital parity with leaders or to help differentiate the banks positioning in the marketplace
- Evaluate the maturity of the bank existing technical environment to determine if enhancement of existing architecture will enable long term digital aspirations or if development of net new system architecture is required
- Adopt an ecosystem mindset and identify partners who can quickly fill known technology, service or feature gaps

Culture & talent

As the banking marketplace shifts towards a more technology-centric environment, the race for top talent becomes increasingly competitive. Incumbent banks now must compete against the startup growth culture, brand experience, and social impact that Challenger Banks offer.

Traditional banks have long struggled to shed the perception, and reality, of bureaucracy and uncertainty while the attractiveness of a flatter, more dynamic and entrepreneurial environment in a Challenger Bank, where individuals can make a greater impact, is appealing in today's working culture. Traditional banks have also relied too heavily on the bank's brand—and while the names of incumbent banks are often recognized globally, just the names themselves are no longer enough to attract top talent. Developers and the like are energized by solving interesting and complex problems. Most recently, HackerRank asked 70,000 software developers what they prioritize during a job search and roughly 72% responded stating "professional growth and learning" as the most important factor.²³

The demand for advanced technology skills is expected to grow by 50% in the US by 2030. However, Deloitte research shows there are issues on the horizon with fewer than 10,000 AI specialists existing worldwide today. By 2022, cybersecurity will hit a workforce gap of 1.8 million.²⁴

²² <https://www2.deloitte.com/us/en/insights/industry/financial-services/financial-services-industry-outlooks/banking-industry-outlook.html>

²³ <https://research.hackerrank.com/developer-skills/2019>

²⁴ https://www2.deloitte.com/content/dam/insights/us/articles/6546_talent-and-workforce-effects-in-the-age-of-ai/DI_Talent-and-workforce-effects-in-the-age-of-AI.pdf

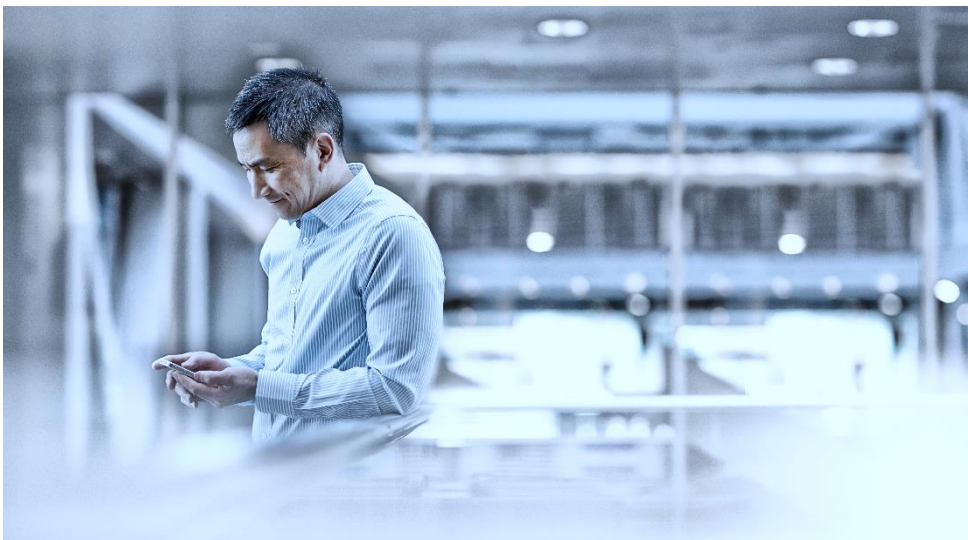
In addition, Millennials have grown to become the largest generation in the US labor force, according to Pew Research Center, accounting for circa 35% of the workforce.²⁵ Millennials seek for a career of purpose, flexibility, and creative opportunities and less a job for life with a monthly paycheck that pays the bills. A study by Deloitte Consulting found that almost 80% of millennials would be more motivated and committed at work if they felt their employer made a positive impact on society.²⁶ As Challenger Banks champion customer centricity and seek to offer financial services to the under- and un-banked population, they promote the meaningful social impact Millennials and the upcoming Gen Z workforce are seeking for.

The underlying distrust of financial services in the market has also played an impact in attracting top talent. With a combination of digital innovation and societal mission, Challenger Banks are shifting the perception of financial services. The question that remains to be answered is if challengers can maintain their appeal and culture as they continue to grow. Will scale and regulation erode the entrepreneurial culture and with it their appeal for top talent?

In today's era of technological, demographic, and geographic disruption, incumbent banks should consider redefining their workforce of the future strategies by identifying the kinds of jobs and skills required to meet future business demands, along with a plan to mobilize for desired outcomes and attract, retain, and incentivize top talent.

Key actions for incumbents

- Identify what the future and nature of work will look like for the organization
- Devise an associated hiring and upskilling strategies
- Identify opportunities and define strategy to shift existing institutional culture to an environment that is values based and champions innovation



²⁵ <https://www.pewresearch.org/fact-tank/2018/04/11/millennials-largest-generation-us-labor-force/>

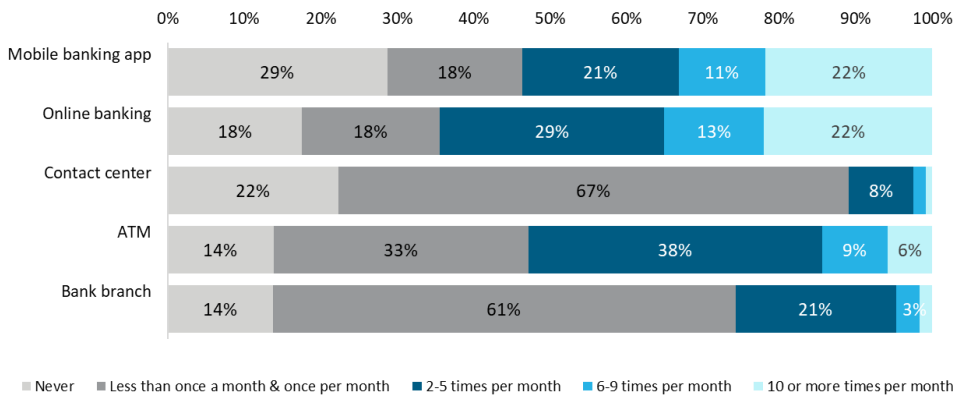
²⁶ <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/About-Deloitte/gx-2018-millennial-survey-report.pdf>

III. Why the US and why now?

The US stands out as trailing other regions in the emergence manifestation of digital Challengers. We believe this is about to change.

US Retail customer expectations are evolving at an unprecedented pace. Through this evolution of needs, customer preferences in banking are now more diverse than ever before. Overall, consumer preferences are shifting towards digital with a declining importance of access to bank branches.

Respondents used mobile and online channels most frequently²⁷



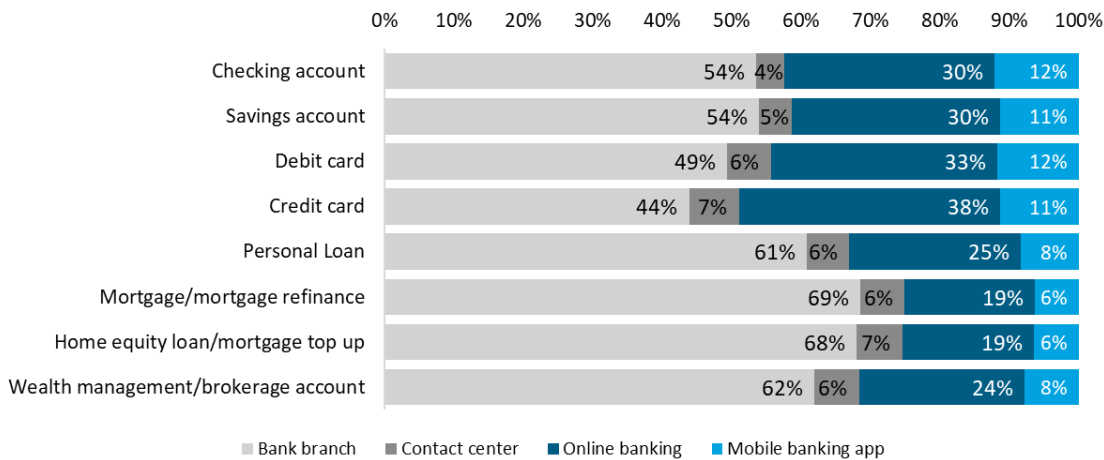
This trend is exacerbated by the never-ending growth in e-commerce activity and purchases. Challengers with their digital-native proposition are well placed to capitalize on this development. Due to the inherent complexity of an incumbent’s IT architecture, the long lead time for changing their digital offering gives challengers a time window in which to press their competitive advantage in digital.

²⁷ <https://www2.deloitte.com/us/en/pages/financial-services/articles/consumer-banking-survey.html>

COVID-19 impact

- Use of mobile banking apps reached 72% of customers at the four largest US banks in April 2020, up nearly 10 percentage points from 2019²⁸
- Mobile check deposits have soared. In March, the dollar volume for mobile check deposit was up 50% over the month before. The number of checks deposited through a smartphone rose 40%²⁹
- 6% of new banking customers indicated they were using mobile banking for the first time; 4% said the same of online banking
- **35% of customers have increased their online banking usage during COVID-19, with a significant share of growth coming from digital immigrants such as Boomers**

Most respondents prefer traditional channels to handle complex or advisory services



Source: Deloitte Center for Financial Services Analysis

While brick-and-mortar branches are arguably one of the biggest differentiators against Challenger Banks, US incumbents have been heavily reducing their branch network in order to optimize cost. According to the US Federal Reserve, 40.7% of rural counties in the US lost bank branches between 2012-2017 which is driving *an increase in the underbanked or underserved population across the US*.³⁰ This is creating the right conditions for Challengers to disrupt the status quo and repeat their success penetrating these segments. And with mobile penetration for adults in the US standing at 83% and growing, accessibility is no longer a constraint for digital-only offerings³¹.

However, wide-spread disruption has not happened yet. The US has seen several digital-native Challenger Banks entering the market with mixed results. Chime for example

²⁸ <https://stories.wf.com/digital-banking-soars-in-the-covid-19-pandemic/>

²⁹ <https://www.americanbanker.com/news/digital-banking-is-surg-ing-during-the-pandemic-will-it-last>

³⁰ <https://www.federalreserve.gov/publications/files/bank-branch-access-in-rural-communities.pdf>

³¹ <https://www.statista.com/statistics/218773/us-smartphone-penetration-by-age/>

started in 2013 and acquired 5 million customers since its inception. Noticeably, foreign Challenger Banks have been absent from the US market until recently.³²

European Challenger Banks are now launching in the US under a sponsor bank model where they partner with a FDIC registered domestic bank. N26 partnered with California based Axos bank when it launched in the US, ensuring that they could immediately offer the 100,000 US pre-registered customers a debit card and deposit account. N26 is the face off to the customers whilst Axos delivers the underlying product. Regulators favor this approach as it affords the Challenger Bank an acclimatization period to fully adapt to the unique nuances of the US market before a license is granted, plus ensures they are “mentored” by an FDIC approved bank from the outset

Further, opening of US regulation in favor of fintechs is accelerating. The Office of the Comptroller of Currency (OCC) now accepts applications for Special Purpose National Bank (SPNB) charters, which allow non-deposit fintechs to engage in one or more core banking activity without taking deposits or being insured by the Federal Deposit Insurance Corporation (FDIC)³³. In conjunction, the Treasury recently endorsed these SPNB charters and responsible innovation in the Financial Services industry³⁴. And more changes are about to come...

As the barriers to market entry are reducing, we are likely to see an increase in competition from digital challengers in the market.

Based on infrastructure considerations, changing customer needs and preferences, and potential regulatory changes, incumbent banks need to tread carefully when approaching their future strategy and how they plan to compete with Challengers as they enter the US market. If incumbents fail to consider this threat now as part of their broader business strategy, they potentially risk slowing customer acquisition as well as similar customer attrition levels seen in Europe



³² <https://www.thebalance.com/chime-bank-review-4580300>

³³ <https://www.occ.gov/topics/supervision-and-examination/responsible-innovation/summary-explanatory-statement-fintech-charters.pdf>

³⁴ <https://buckleyfirm.com/sites/default/files/Buckley-Sandler-Special-Alert-OCC-Fintech-Charter-and-Treasury-Report.pdf>

IV. Conclusion

The US already has its modest share of Challenger Banks, but the scale of penetration and disruption seen in other mature markets has not yet happened even though these banks have access to the same talent and technology as other players around the world. This indicates the barriers to disruption to be external customer preferences or of regulatory in nature.

However, the shifting US customer expectations are slowly moving towards a more digital banking mindset and the regulatory climate in the US is opening in favor of innovation. The question now becomes no longer *whether* this level of disruption will happen in the US, but *when*.

It remains to be seen how profitable Challenger Banks will become, and which Challengers will last in the long run. The oversaturation and rapid growth of challengers could cause sustainability issues and drive a variety of exit and accelerated profitability strategies e.g., acquisition by an incumbent or other FS institution, joint ventures, or for the most robust, maturity into a long term national and international competitor across multiple products and business lines

However, what is already proven is that Challenger Banks are causing major disruption across the banking value chain with their ability for rapid customer acquisition being the most impressive. Thus, at a minimum, **incumbent US banks must look at ways of evolving their own DNA** in the context of this new potential threat to futureproof their business. Whether or not this potential threat will fully materialize is open for debate—however, regardless of the ultimate level of disruption, the evolution of Challenger Banks offers interesting learning opportunities for incumbents.

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