



TEN TALK: Episode 5 - Neobanks: Banks by any other name?

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Terri Bradford examines so-called “neobanks” and finds that despite the name, these digital providers of financial services really aren’t banks.

Audio File: [Ten Talk Episode 5](#)

Rick Babson: Hi, and welcome to TEN Talk, a podcast by the Kansas City Fed. I’m Rick Babson, the managing editor in the Bank’s Public Affairs department, and I’ll be your host today for this episode. With me today is **Terri Bradford**. Terri is a senior payments specialist in our Payments Strategy department. Thanks, Terri, for taking time to visit with us today.

Terri Bradford: Well, Rick, thank you so much for having me. I look forward to speaking with you.

Babson: You’re welcome. And I appreciate you taking time to visit with us today. Terri, I know during your time at the Kansas City Fed, you’ve written pretty extensively about developments in the payments industry and payments strategy, both for our quarterly **Economic Review** and the **Payments System Research Briefing**. So, I wonder if you could remind us please, why is Kansas City so interested in payments?

Bradford: Well, Rick, during my tenure here at the Kansas City Fed, we’ve always had an interest in payments and payments innovations. Back when checks were the dominant form of payment, we were interested in how we use that MICR line in order to provide information ahead of the physical check’s arrival. And that pretty much led to what we see today as Check21. As the internet began to be adopted, it changed the ways that payments were made as well. And that led to electronic bill presentment and payment and person-to-person payments as we know them today. And, thinking about what we’re in the midst of now with real-time payments, we started taking a look at how those were being made in other countries, and now that’s the direction we’re heading in the United States. And it’s an effort that our Bank and our Bank’s president, Esther George, has played a leading role in, in the (Federal Reserve) System.

Babson: And thanks for that background. And now more recently, I know you’ve **examined what are known as “neobanks,”** and while I’m a big fan of the “Matrix” and the movies, and I know a lot of people are, but I’m guessing that neobanks don’t have much to do with the Keanu Reeves’ character in those movies, do they.

Bradford: No, not really. Although I shouldn't say that because there seems to be a neobank for every niche of society. So, perhaps there is one Rick, but I'm not necessarily aware of it. So, basically, neobanks have been around for quite a while now. You may not think of them quite the same as you see them today, but it's probably been about a decade since the first one was introduced. And if you think back to a neobank like Simple or Moven, they were created about 10 years ago to make the banking process less intimidating, less costly, easier to navigate. So, they've been around for a while.

Babson: And I'm sure most everybody would agree that anything that eliminates fees and makes for a less-intimidating banking experience would be beneficial. So, who exactly are we thinking about in terms of the customers for these neobanks?

Bradford: Well, there's actually quite a range. Just for purposes of simplification we'll bucket them in a couple of different ways. Some are targeting, let's say small business owners or entrepreneurs, freelancers. There are others that are targeting students and Millennials, yet others that target the un(banked) and underbanked and hourly workers, and still some that are targeting affinity groups. So, if you are someone who is very concerned about the climate, you might choose a neobank that has a focus of doing things or initiatives that help to save the climate or invest with companies that have that thought in mind.

Babson: So, clearly neobanks sound like they're identifying the niche groups to go after, and do these neobanks and the niches they are trying to occupy, are they offering products and services that are the same or similar that what's offered by traditional brick-and-mortar banks, or are neobanks offering something that's completely different?

Bradford: Well, I would say that it's a mix of both. Of course you're going to find the traditional services that you'd find at a brick-and-mortar bank ... your checking account and savings accounts and that type of thing. I think the differentiation comes in the way that those services are offered. First of all, most of these neobanks are primarily digital. So, you won't find them in your neighborhood or on a corner anywhere. They're going to be online only by and large. Another thing that's interesting is that they tend to target specific segments of the market. And since they're not trying to be kind of a one size fits all, you see offerings that are tailored to specific groups. One thing that's pretty common across all the segments though, is that many of them will offer early access to pay, which can be very important. So, you can get access to your paycheck up to two days early. The majority of them, I should say the overwhelming majority of them, don't charge any fees at all for the services that they offer. Some help with investing, budgeting, in targeted ways. So, you would have those that would tap the gamification of savings; some offer micro investing. So, according to what specific segments' interests are, there's probably a neobank that's targeting them.

Babson: The term gamification of banking services shows to me that we really are entering a brave new world, certainly. And, despite the name neobanks, they're really not banks, are they?

Bradford: No, they really aren't. The overwhelming majority of them have a relationship with at least one other bank in the background. And if they're offering a demand deposit account, the actual traditional bank is the one that's providing the FDIC insurance for those funds. They have relationships with card issuers in order to be able to have branded cards and so forth. So, the overwhelming majority of them are not banks as we think of them, but they offer financial services that make them bank-like.

Babson: So, if it looks like a bank and it talks like a bank ... I think you can get the idea where I'm going with this. Do neobanks have any ambition, or are there any incentives, for them to actually become real banks?

Bradford: Well, they'd have to go through the process of getting a banking license in order to be a real bank. It kind of sounds like Pinocchio. "I want to be a real boy." Not necessarily do all of them want to actually become a bank. A lot of these are technology companies that are finding ways to offer services in a more streamlined fashion, but there are those that do aspire to become a bank. And examples of those would be Varo, which started as a neobank, but was able to achieve a banking license. Another example is Monzo, which is an internationally based bank. I believe they're in the U.K., but they've also established services here in the United States. And they don't have their banking license right now, which makes them a neobank, but they are pursuing getting one. So, ultimately they do desire to become a bank. Additionally, the Office of the Comptroller of the Currency does have a fintech charter. It hasn't really been embraced and it's now proposing a national payments charter. So, even though right now we don't see neobanks gravitating toward these charters, there's nothing saying that down the road, they won't apply to become a full-on bank.

Babson: Middlemen everywhere are cringing right now with the thought of being cut out. But, that's a topic for another podcast. So, I was just wondering, are there examples in the Tenth District currently that, where we have established ... established may be too strong a word ... that there are neobanks operating in the Tenth District now, or are there others that might be ready to launch sometime in the near future?

Bradford: One that I'm aware of that's in the market now is called Wicket. And it's probably a neobank in the terms that we think of just trying to simplify the banking process and eliminate the fees that are associated with banking. And that is a Tenth District bank. And one that's on the horizon I believe, expecting to launch next year, is First Boulevard. From what I understand about First Boulevard, it's aim among many will be to eliminate the wealth gap for Black America. So that will be another to watch and be interesting to see it as it comes online.

Babson: Definitely something to look forward to. I'm wondering what type of effect currently, if any, are neobanks having on the brick and mortar traditional banks? Are they seen as real competition and, and if they are, how are traditional banks responding?

Bradford: That's a really good question, Rick. Traditional banks are responding and in different kinds of ways. We're seeing some that are actually providing services to these neobanks. So, I don't know if you've heard of banking as a service, but they're enabling neobanks to function as what appears to be a bank to the consumer. So, there are those that have gotten into the backend side of it and providing services. There are others that are competing directly. And one that comes to mind is Goldman Sachs' neobank called Marcus. So, they kind of spun up their very own neobank. It's outside of Goldman's, to compete or to be among the many neobanks that are out there. We've also seen that some credit unions are targeting segments of consumers. For example, small businesses with services that you also see offered by neobanks, but I'd have to say the overwhelming majority of financial institutions at this point are probably in the observation mode, to see if this is something that's really going to stick.

Babson: It's a little easier to see what's in it, perhaps, for the traditional banks that maybe facilitate or compete directly with neobanks, but out of the banks that are observing what's going on, how do they benefit from their action or really from their inaction?

Bradford: Well, at this point, I think a lot of financial institutions have to pick and choose what it is that they're focusing on. And there's a lot to deal with right now in terms of financial services and the industry at large. So, taking a wait and see approach, I guess, isn't that uncommon in such instances. Probably just trying to figure out at this moment in time where resources are best spent. So, those that are observing may be trying to figure out what their next move is and how best to address the issues that they see arising in financial services more broadly, and as a result of neobank participation. From that standpoint, I'd say that the Federal Reserve's FedNow and The Clearing House's RTP services, may be helpful in allowing some of these financial institutions to compete in terms of offering services that neobanks are offering that seem appealing ... for example, providing access to wages earlier than what we're experiencing right now. So, as payments begin to move faster and there's security around those payments, we may see some innovation from banks that aren't quite fully dipping their toe in the water at this point, and in figuring out how they're going to compete or co-exist in the space with neobanks.

Babson: Definitely. It will be interesting to see how FedNow rolls out and what its effect may be. And I'm just wondering too, as we've covered a lot of territory here in a few minutes, but is there anything about neobanks that we haven't talked about that you think might interest our listeners?

Bradford: I guess what I would say is that while there isn't necessarily a personal relationship, I mean you're not going to be able to walk into a branch and have a conversation, I find the idea of the targeted nature of some of the neobanks to be interesting. Particularly those that appeal to socially and environmentally conscious consumers. I think it's going to be interesting to see what type of traction they gain. I also think that traditional banks' reaction to neobanks will be something that will be interesting to observe as well. For example, there could be another Marcus on the horizon. But again, I'm anxious to

see what those that are targeting specific niches, like eliminating or minimizing the wealth gap in Black and Brown communities and facilitating the un(banked) and underbanked to have access to financial services and investing in those types of things. I'm really interested in seeing what kind of headway these neobanks will be able to make, and what kinds of inducements come from that in terms of what traditional banks are offering. So, looking forward to the developments, Rick.

Babson: Me too. Perhaps we'll talk about this again sometime soon. Terri, I want to thank you for your time and your insight today, talking about the rise of neobanks. You can find more of Terri Bradford's payments related research on our public website. And as always, the views expressed today are those of the host and guest, and don't necessarily represent the Kansas City Fed or the Federal Reserve System. You can find more of our [TEN Talk podcasts at KansasCityFed.org](#). Thanks for listening.
