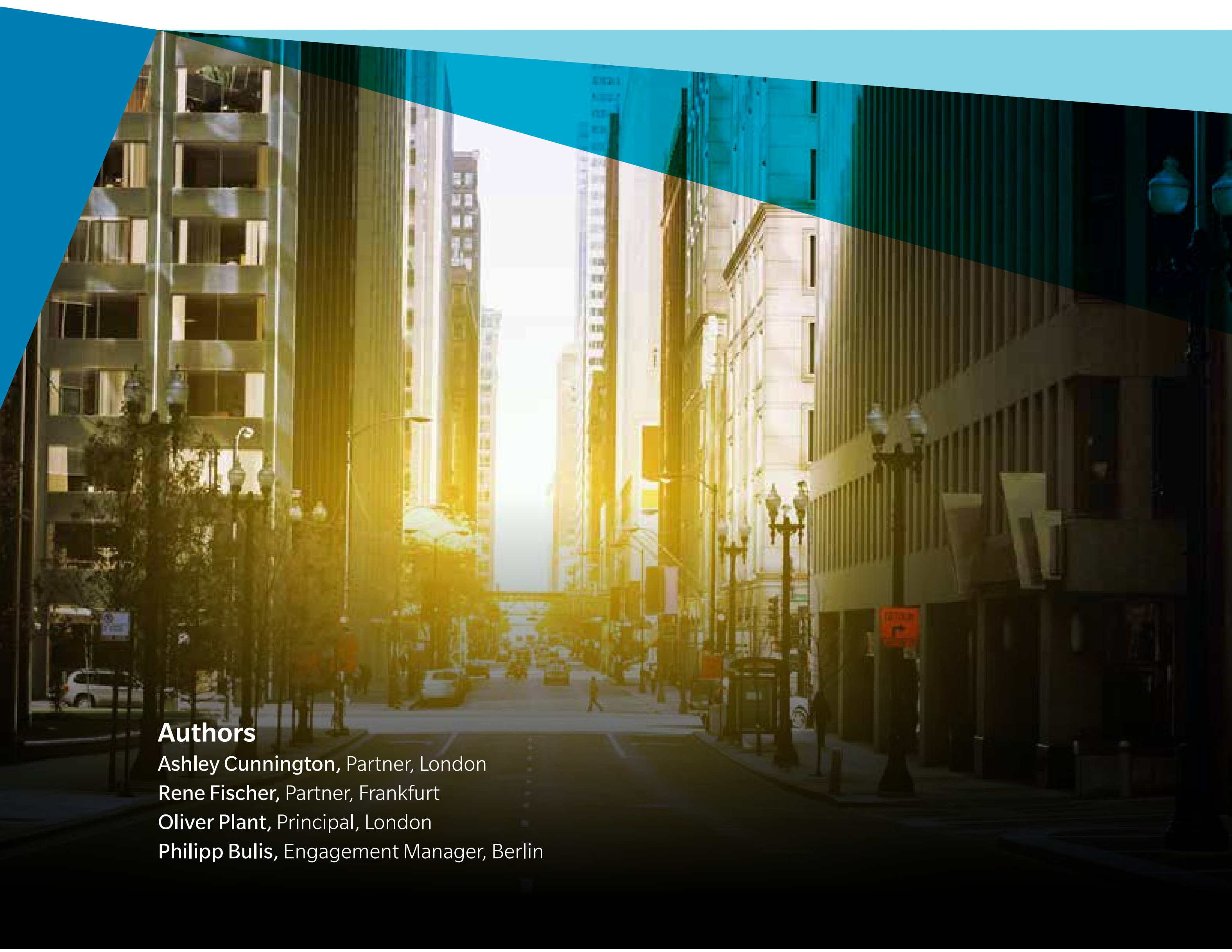
OLIVER WYMAN

THE CURRENT ACCOUNT CONUNDRUM

FOLLOW THE MONEY



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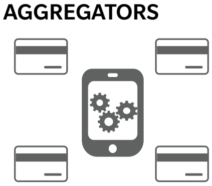
EXECUTIVE SUMMARY

If you ask a consumer whom they bank with, chances are they will give you the name of their main current account provider. The current account occupies a special place in banking – it's the focal point of the customer relationship, the gateway to other products and services, and a source of rich transactional data.

Yet this market is in a state of flux: Incumbents face significant challenges from eroding revenues and stubborn legacy cost bases; technological advances are opening new possibilities for new banks (or greenfield propositions within old ones) to enter with slicker propositions and much lower costs; and regulatory changes are enabling new ways to facilitate banking without actually being a bank.

It is hard to predict exactly how these market forces will play out, but we have drilled into the economics of current accounts to shine a light on the factors that will determine who succeeds and who fails, and to highlight priorities for decision makers.

Exhibit 1: Summary of economics and implications

	ECONOMICS	IMPLICATIONS
INCUMBENTS 	• Current accounts are generally loss-making on a standalone basis • Revenues are under pressure from multiple sources • Costs are high and stubborn due to legacy infrastructure and branch network – barriers to entry becoming greatest liability • Profitability is contingent on cross-sell of other products for the majority of customers	• Focus required on revenue/pricing models to mitigate direct losses • Need to jealously defend customer relationship by increasing affinity/engagement to protect cross-sell • Cost reduction is a must – can be tackled via evolution or revolution • Scale of business and size of financial resources mean that building or acquiring successful propositions/platforms are both options
NEO-BANKS AND GREENFIELDS 	• Operate at a fraction of the cost of incumbents with a highly scalable model • Generating revenues is a significant challenge due to low deposit balances, low fees and acquisition costs/pricing levels • At scale, likely to break even on core revenues alone but rely on achieving primacy or cross-sell/3rd party income to be profitable	• Proposition must be good enough to overcome switching inertia to achieve relevant scale in the market • Need relentless focus on core and incremental revenue model • Have to scale to satisfy investor expectations, justify investment in ecosystem build and/or become an attractive acquisition target • Must keep costs in check as complexity of business grows or remains simple
BANK AGGREGATORS 	• Thin operating cost and revenue model compared to bank model • Relies on extremely low cost of acquisition and near zero marginal cost to serve given slim economics • Little to no direct revenues from majority of customers, requiring alternative revenue strategy	• Requires a massive customer base – clear opportunity for Big Tech players, telcos and others to tack aggregation onto existing offering • Focus must be on building customer engagement and paving the way for future monetisation • Opportunity to later back into bank model to take full economics

INTRODUCTION

In our State of Financial Services Industry 2018 report: T*he Customer Value Gap: Re-calculating Route* we wrote about the impact that technology has had on different areas of people's lives. We underlined the importance of the **proposition creating value for customers** – which in turn allows firms to better acquire and retain customers – and hypothesized that the winners will be those who can close the customer value gap and reap the rewards.

In this Point of View, we use an **economic lens** to explore how this dynamic is playing out in transactional products and services aimed at the retail customer, with a focus on **what makes or loses money**. We look at the environmental and competitive forces, which are eroding the status of the current account provider as the historic lynchpin of the banking connection with the customer and examine the **product and relationship economics** for different player categories. We conclude with an examination of the implications for different categories of players and a series of recommendations for each type.

We have focused on three categories of player as defined below for the purposes of this paper. However, many of the same points are applicable to a broader range of existing and potential future marketplace participants. Firms from the retail, telco, or technology sectors may choose to move into one of these categories through direct entry or acquisition, bringing with them trusted brands, large and engaged user bases, and synergies with their core businesses. We also foresee a blurring of the lines, as players seek to raise the bar on customer experience and interaction, generate revenue streams beyond their core offering, and expand their role in the value chain.

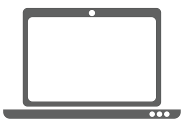
Exhibit 2: Categories of players addressed in this report

CATEGORY	DESCRIPTION	EXAMPLES	
Incumbent	A large, established, full-service retail bank with a significant share in the personal current account markets and legacy infrastructure	• Lloyds Bank • Société Générale • HSBC	• Deutsche Bank • Crédit Agricole • Santander
New-banks/ greenfields	A recently-licensed regulated bank or e-money licensed player which interacts with customers predominantly via the mobile channel	• Revolut • Monzo • mBank	• N26 • Starling Bank • Nickel
Aggregator	A non-bank which facilitates banking activity for consumers as a serve-based aggregator and enricher of customer data	• Linxo • Meniga • Money Dashboard	• Numbrs • Yolt • Bankin'

THE WORLD IS CHANGING

A common theme in many European markets is the high level of concentration in the current account market. Since the Financial Crisis we have seen greater distrust in banks and increased competition to own the customer relationship but relatively little change in market share outside of merger-driven consolidation.

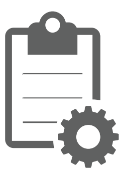
We would, however, highlight several recent trends that threaten to accelerate change in the technological, profitability and competitor dynamics in retail banking.



Customer shift to digital channels. The dramatic channel shift of sales and services to digital allows scalability to companies using technology wisely and designing processes to maximize the "happy path" experience. In many Western European markets, digital product sales are common, and the branch network is seen less as a strategic asset and more as a stubborn cost centre that most incumbents are shrinking at pace.

Technological infrastructure advances and availability. The modularization of the technology stack allows new entrants to rapidly spin up processes and systems using a combination of in-house build, partnership, and acquisition. Greater availability of data, advances in analytical processing, and scalable cloud technology have brought down the cost of market entry from hundreds to tens of millions of euros. Agility and a culture of continuous development also favor younger, more open firms.

Revenue pressures. Interest rates are at historic lows, limiting banks' ability to generate net-interest margin. Increased regulatory scrutiny and media pressure have led to paring back of fees and rates. Cheaper alternative providers in certain niches (such as international remittance) have put pressure on banks to lower charges to stem leakage. High profile regulatory actions against mis-selling (such as PPI or SME derivatives) and more direct accountability of senior management are an added incentive to be whiter than white.



Regulatory and industry movements. Regulatory initiatives are allowing new players to access data and acquire customers. PSD2 across Europe and Open Banking in the UK provide common standards for customer-initiated data exchange and cross-account instruction. GDPR came into force in May, bringing updated standards on data portability and access rights. Public and private current account switching services – such as CASS in the UK and Zahlungskontengesetz in Germany – have facilitated millions of switches.

Competition and the rise of fintechs. Recent years have seen a proliferation of financial technology firms, built on modern technology to solve the problems of today's customer. Retailers, telcos, and alternative finance providers are also moving into becoming fully regulated banks. Big tech firms have so far focussed on payments and eWallets. However, is the news of Amazon's recent discussions with JPMorgan Chase in the US a sign of tech giants bringing their war chests to bear on personal current accounts? Emboldened by the success of technology in taking a share of revenues in other industries, such as music, video, and transportation, and with over a trillion euros in global revenues at stake, why might banking not be the next stage for tech disruption?

FOLLOW THE MONEY

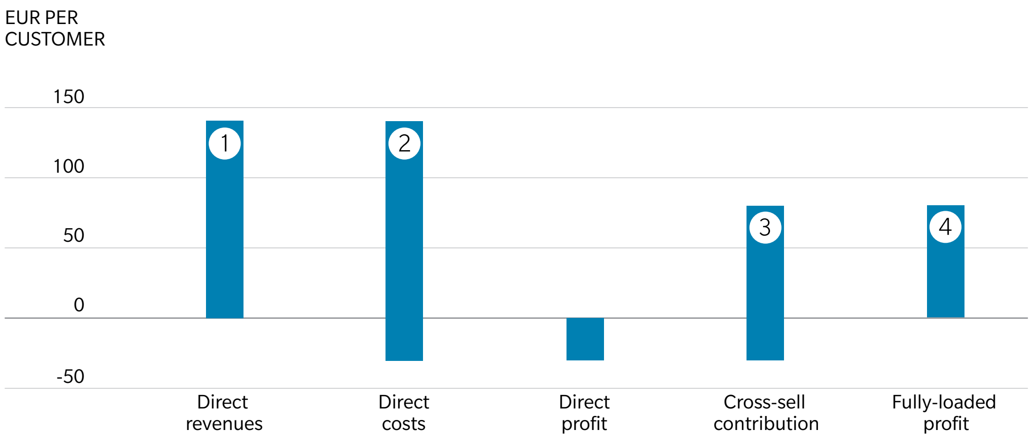
In this section, we examine the factors driving the economics for different categories of market participants, as a means of understanding the actions that economic logic would dictate.

INCUMBENT BANKS

Mass-market current accounts today don't drive returns on a stand-alone basis. While there are regional differences in the direct unit P&L, the personal current account is typically a low margin – and in the aggregate, loss leading – product. Why then have incumbents been investing in cash incentives, above-market rates, and marketing campaigns to win share? The primary reasons are to own the customer front-end experience, gain valuable data on her/him, and deepen the relationship to aid cross-sell of other products to the customer, as well as build a base of low cost funding over the long term.

Faced with competition from existing peers and new players, incumbents will need to act to stem attrition, bolster inflows of new customers, and avoid accounts being exploited as pseudo-savings accounts by "rate tarts" or empty vessels passing funds elsewhere.

Exhibit 3: Incumbent PCA typical unit economics



1. **Direct revenue under pressure** – Low rates have diminished the advantage of free float from non-interest bearing balances; competition and regulatory pressures have put pressure on fees and overdraft rates
2. **Large and stubborn cost bases** – branch, tech and FTE costs are proving difficult to bring down and impacting customer service model and generating negative PR
3. **Cross-sell revenues increasingly at risk** – high value of cross-sell – particularly mortgages but also savings, consumer finance etc. – starting to suffer from disintermediation as move to digital channels and ease of comparison erodes loyalty for commoditised products
4. **Cost control and retaining cross-sell** – managing customer value and pricing, dramatic cost reduction to level playing field with new entrants and cross-sell required

Source: Oliver Wyman analysis

PRIORITY ACTIONS

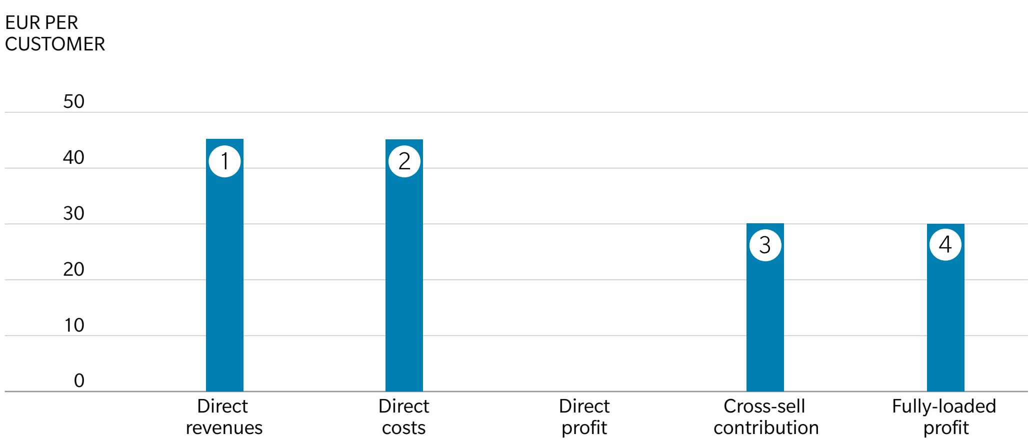
- Optimise revenue to minimise direct loss while creating value to win and retain customers
- Aggressively manage costs, via network right-sizing, automation, and re-platforming/greenfield build
- Defend cross-sell with coherent propositions and experiences by retaining engagement and loyalty

NEO-BANKS AND GREENFIELDS

New entrants have a big advantage – they can build from scratch to operate at much lower costs, with greater flexibility and superior customer journeys. However, they need to acquire customers in a largely inert market. And so they need to give them something compelling. This typically means better experience and offering preferential economics, for example charging less for FX or credit.

Distinct business models are emerging, as some offer a freemium model, others position themselves as the control center at the heart of a marketplace, and others develop B2B software and connectivity offerings.

Exhibit 4: Neo-bank PCA typical unit economics



1. **Direct revenues anaemic outside premium models –** driven by common decision to forgo most overdraft and FX fees; low balances due to limited track record, primacy and deposit-poor demographic; limited opportunity to deploy funds via narrow product suite
2. **Radically lower cost bases –** no branch costs, nimble and able to experiment at low cost, supported by VC free float, prioritising user growth over short term revenues
3. **To broker or manufacture –** most neo-banks focussing on own core transactional product(s) and looking to broker other products in FS (e.g. credit card, mortgage) and other industries (e.g. energy switching)
4. **Primacy or cross-sell to drive profitability** – capturing salary mandate and associated balance /usage uplift in tandem with acting as a gateway to cross-sell into ecosystem

Source: Oliver Wyman analysis

PRIORITY ACTIONS

- Scale customer base without piling on overhead, to spread fixed costs and gain negotiating clout
- Reinvest cost savings into proposition and incentivising primacy and relationship share
- Seek to intermediate product manufacturers, create value for customer and take a cut

CASE STUDY: AGGRESSIVE COMPETITION FROM THE NEO-BANKS

- **Monzo (750 K customers)** won over the UK travel-hungry demographic by offering interbank currency rates and charging little or no fees and involving customers in product and even fee structure choices
- **Revolut (2 million customers)** started as a currency exchange provider but quickly launched insurance and cryptocurrency alongside current account functionality to UK, select European and global geographies
- **German neo-bank N26 (1 million customers)** offers Black and Metal premium credit cards, targeting premium customers with perks, such as credits at partner company WeWork, global travel insurance, and a tailored, specific card design. N26 report 30 percent of their customers have a premium account

Exhibit 5: Revolut case study

In April 2018, Revolut became the UK's first digital "bank" unicorn valued at $1.7 billion in a $250 million fund-raising round. It has acquired nearly 2 million customers in the three years since it launched an app and prepaid card, is signing up between 6,000 and 8,000 customers a day and is aiming to acquire 100 million users in the next five years.

It has been among the most successful neo-banks in monetising its proposition and reached breakeven in December 2017. The majority of its revenue comes from

- Fees on customer accounts (Premium accounts, physical/virtual card issuance, ATM withdrawals, FX surcharges for illiquid/volatile currencies or when FX markets closed)
- Non-current account cross-sell fees (cryptocurrency, insurance, personal loan)
- Other (interchange, business accounts)

REVOLUT TIMELINE

Year	Month	Event	Further event
2015	JULY	Launch of an app to exchange or send money and an optional prepaid card	
2016	DEC	Cap for free ATM withdrawals lowered and £5 fee introduced for cards	
2017	FEB	Launch of UK current accounts with personal UK IBAN and chatbot	
2017	MARCH	Offers credit loans in partnership Lending Works	Offers fee-based premium account with higher fee-free usage limits
2017	APRIL	Partnership with Trussle online mortgage broker service	
2017	JULY	Launch of accounts with personal European IBAN	
2017	AUG	Launch of business current accounts	
2017	SEP	Partnership with Simplesurance to launch UK Smartphone insurance	
2017	NOV	Applies for European banking licence	Exceeds one million customers across Europe
2017	DEC	Launch of crypto-currency with access to Bitcoin, Litecoin and Ethereum	First break-even month
2018	JAN	Launch of pay-per-day travel insurance	
2018	MARCH	Introduces disposable virtual cards	
2018	APRIL	Raises further $250 MM at $1.7 BN valuation	

Customer Numbers

- 330 K
- 500 K
- 800 K
- 1 MM
- 1.2 MM
- 1.5 MM (Februrary)
- 2 MM (June)

Source: Company website, CrunchBase

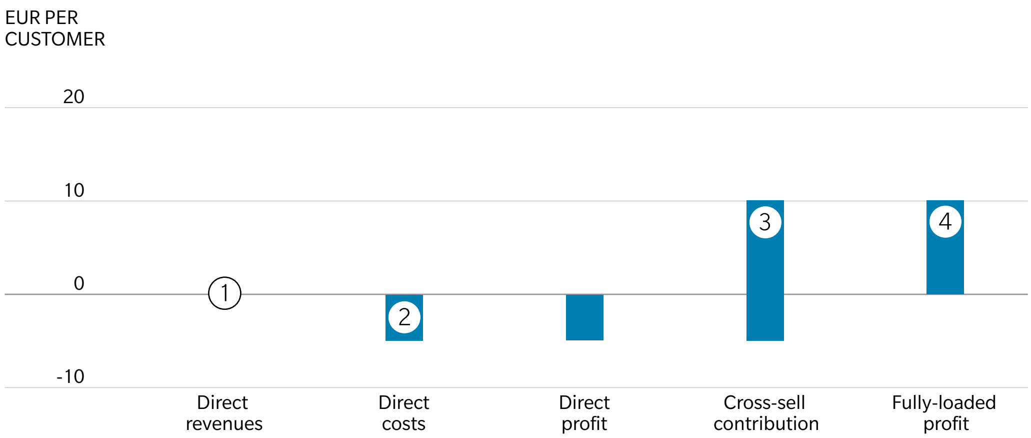
AGGREGATORS

Account aggregation has been growing as part of the move to banking becoming more "modular", and Open Banking and PSD2 are both likely to spur adoption. It allows consumers to see and manage their bank assets and other products in one place. Platforms can run a one-stop-shop where customers can compare, buy, and operate banking products, helping the customer select the right product based on transaction analysis, external data sources, and knowledge of provider eligibility and scorecard models. (See Exhibit 6.) By providing a service that is typically free at the point of use they can acquire vast numbers of customers. By not being a regulated bank, they can operate with much lower regulatory and capital costs, although they also forgo the balance sheet banking returns. This may be an attractive entry point for Big Tech to expand their core offerings and develop brand credibility in financial services.

CASE STUDY: SERVICE-BASED AGGREGATOR CUSTOMER ACQUISITION

- The Numbrs app is used to manage over 1.5 million German accounts and as a marketplace to buy third-party products (e.g. loans) in its Store
- After three years, ClearScore now provides credit reports to 6 million customers and is a significant credit card intermediary

Exhibit 6: Bank Aggregator PCA typical unit economics



1. **Direct revenues thin to non-existent –** product is typically free to the end user to encourage sign-up and use. Some "Freemium" models in evidence
2. **Ultra lean model –** simple proposition, lower regulatory burden and app/web-driven interface lowers cost to acquire and serve
3. **Leveraging the information advantage –** modern technology, open banking/PSD2 and independence from the banks gives product aggregators credibility to recommend suitable products, charging a fee to the provider
4. **Slim unit economics –** marker of success is surpassing breakeven across a portfolio of customers and scaling up dramatically to benefit from network effect

Source: Oliver Wyman analysis

PRIORITY ACTIONS

- Build a large, engaged user base to gain potential to increasingly monetise over time
- Avoid piling on cost, targeting where and how to play – e.g. is being a regulated bank beneficial?
- Option to back into a new-bank model to gain greater share of revenues from cross-sell

IMPLICATIONS FOR DIFFERENT PLAYERS

INCUMBENT BANKS

- **Focus on customer experience in proposition design.** Customers have started to demand a higher quality of service and increasingly are prepared to take their business to providers who can meet their expectations for the look, feel, and features they expect in their bank. In contrast, many incumbents' processes have evolved in a way that caters to organizational structures (e.g. product lines), system constraints (such as overnight batch processing), and regulatory minimum standards (such as managing complaints). To regain lost ground, incumbents must look at ways to put the customer at the center, and re-design the banking experience from their perspective.
- **Pricing and revenue management.** Bank pricing models have been relatively static and "one size fits all" making it hard to adapt to revenue erosion. Banks will have to consider more differentiated pricing to retain customers who represent a greater flight risk and consider how best to charge for significant value being created or to generate holistic lifetime value on customers who generate significant costs or low revenues.
- **Managing customer value.** Incumbents have struggled to demonstrate that they are providing sufficient value to encourage inbound switching and retention, particularly for the more demanding millennial generation, which will make up approximately half the workforce by 2020. Cross-selling to this credit-hungry demographic – which has a high potential for future earnings and will need mortgages and investment advice over the coming decades – will be at the core of future lending and advisory revenues.
- **Cost management.** Incumbents must aggressively attack costs to deliver shareholder returns and position themselves to compete by reinvesting in proposition. Process digitization and artificial intelligence can automate low-value, high-volume activities. Removing friction and encouraging self-service reduces customer need to use costly, human-intensive channels. Further savings can be gleaned from redesigning business architecture to cut out inefficiencies and leveraging partnerships to minimize spend on commoditized table stakes components. One increasingly popular option is building or buying digital greenfield platforms. Starting with a blank canvas, staffing the effort with innovative, tech-savvy resources, and adopting an agile working style can serve to level the playing field with the neo-banks – and make the incumbent more competitive. But it is not without challenges of culture clash and integration with central systems. Strategies to bring down average costs must either reduce absolute cost, grow customer numbers faster than costs (whether organically, inorganically, or as a product manufacturer for others), or steer away in favour of other revenue-generating activities.

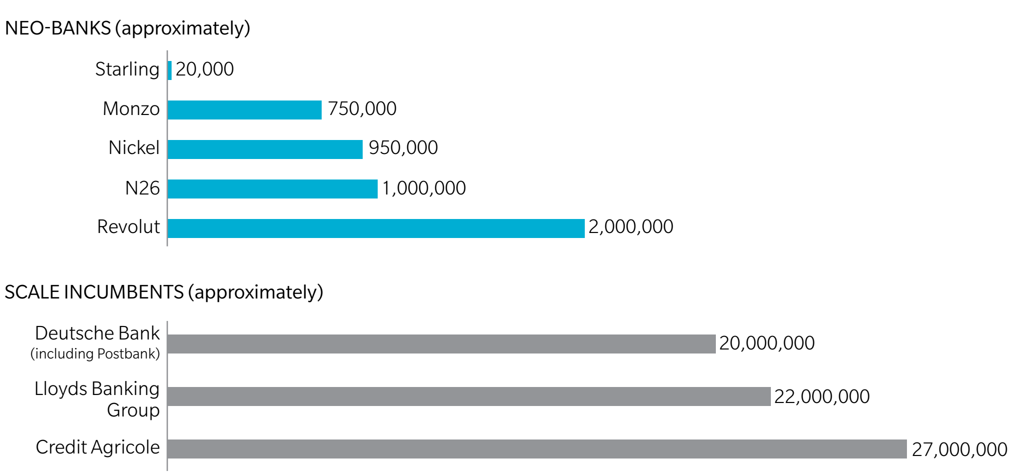
CASE STUDY: INCUMBENT PCA REPRICING:

- In 2016, Deutsche Postbank introduced fees on current accounts after years of advertising free accounts, losing up to ~10 percent of existing customers in 12 months but generating net fee income growth of ~12 percent (~€100 million). By the fourth quarter after fees were introduced net client flows had even turned positive
- In 2016, Santander UK more than doubled 123 current account fees and halved the interest pay rate but reported that 2016 retail current account balances were up £11.6 billion and that it saw net positive inflows in 2017, although BACS data shows a fall in CASS switching gains

NEO-BANKS AND GREENFIELDS

- **Grow and engage the customer base.** For years now, neo-banks have often made headlines and have been much loved by their supporters. But, for all the noise, they remain a fraction of the size of the incumbents. Moves to full current accounts, releases of new features, and forays into value-added services appear to be accelerating the rate of user growth. Low acquisition costs are supported by peer referrals, social media-driven campaigns, and informal events. As well as broadening the customer base – which may increasingly require marketing spend and incentives – neo-banks will also have to drive primacy and sustain engagement. Gaining salary mandates will increase balances and reduce operating costs associated with customers funding their accounts. As rates rise and lending propositions develop, growing deposit balances and expanding credit offerings should allow providers to grow net interest margin. Trust and engagement will be key to securing larger balances, overcoming nerves surrounding large decisions such as mortgages and being the go-to starting point for cross-sell.
- **Develop credible revenue potential.** While the lower-cost operation argument is widely accepted, neo-banks have yet to demonstrate the ability to generate significant revenue. A reluctance to exploit traditional revenue streams, such as FX commissions and unpaid item fees, can be somewhat offset by a higher risk appetite or an ability to rapidly launch new products, for example Revolut's cryptocurrency offering. Building a low friction, highly automated mechanism to capture cross-sell and using this to offset the sunk costs of build and customer acquisition could be transformational for neo-banks' economics.
- **Avoid loading on the costs.** No firm starts with a multibillion pound cost base, but over decades of growth and increased complexity, this has become the case for the biggest banks. Launching a multiplicity of products, trying to be all things to all people and throwing money at commercial, operational, and compliance issues have created behemoths with cost-income ratios that have proved resilient to waves of cost-cutting. Focusing on core capabilities, linking into an ecosystem of other providers, and making trade-offs that keep the administrative burden light will be required to keep costs down. The recent wave of greenfield builds demonstrates that starting again can be more palatable than neverending incremental cost reduction once the costs have piled up.

Exhibit 7: Personal current account customers



Source: Company websites, news articles

Note: Scale incumbent figures are for retail customers in domestic market. Figures are correct as of June 18, 2018

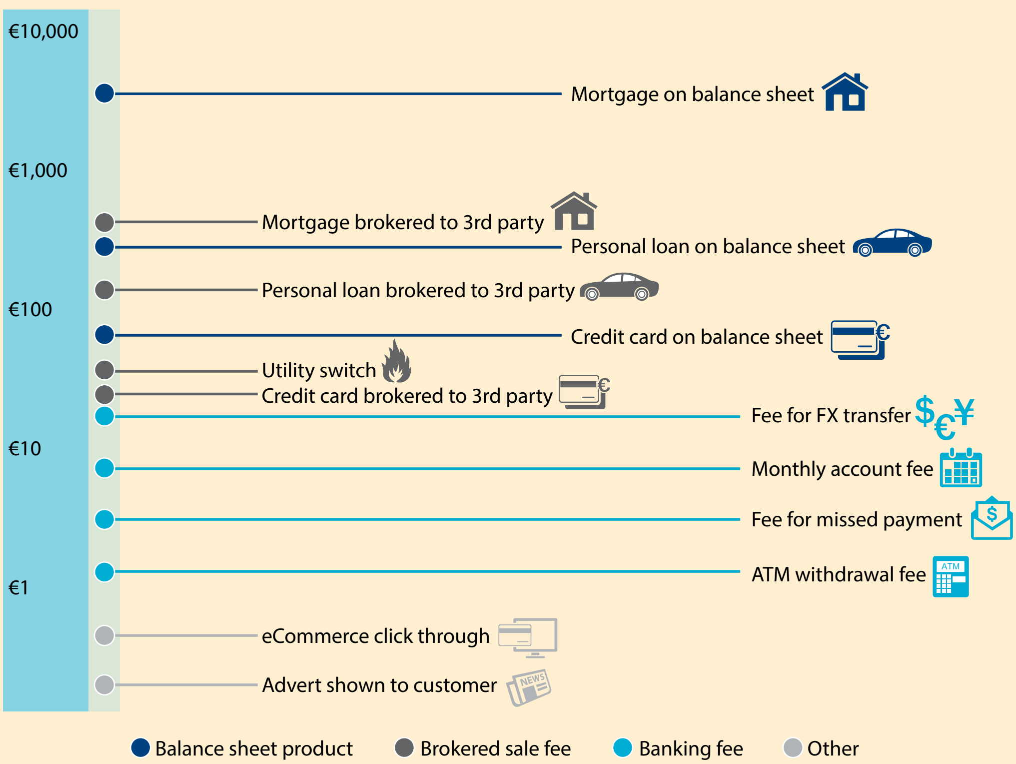
REVENUE STREAMS

Banking revenue streams are at the mercy of many factors.

- Low-interest rate environment has limited banks' ability to generate NIM
- Regulatory and reputational pressure have led to paring back of fees and rates
- Competition from cheaper alternative providers has brought down rates
- Mis-selling scandals and greater accountability have suppressed revenue streams

Stable and low-risk mortgage lending, supplemented by higher risk consumer credit and funded by cheap deposits has historically been the key to retail banking profitability. This has enabled product providers to pay sizable commisions to intermediaries for selling these products. Fee income provides a more modest contribution to profits but is much less capital intensive. Other revenue streams tend to be smaller ticket but at volume can support overall profitability.

Exhibit 8: NPV of different revenue streams



Source: Oliver Wyman analysis

Providing traditional revenue-generating transactional services at low/zero cost to the customer may be what is required to generate customer volumes and drive customers through the ecosystem model and develop more of a financial partner or coach relationship. This may be painful for banks organised and incentivised around traditional product line economics but a failure to accept that the model is changing could lead to significant loss of customers and accompanying economics in the long run.

AGGREGATORS

- **Drive adoption and brand building.** While there has been widespread adoption for many years in some markets (see "Aggregators: a French case study"), take-up of bank account aggregation has been limited in other markets. In the UK, customers have historically been reticent to provide aggregators with their account details, due to security fears. Conversely, search-based aggregators such as price-comparison websites have enjoyed tremendous success in insurance, utilities, and latterly in banking, leading to speculation about whether they might expand into account aggregation. Establishing a trusted brand, getting customers to try the service and stay engaged will build a user base that can be monetized in time.
- **Leverage PSD2 and Open Banking.** These regulatory-driven initiatives allow the integration of the account aggregator and product aggregator business models to provide a one-stop-shop for customers. This has the potential to create real value for customers and accelerate the disintermediation of traditional financial services providers. Attracting customers with free or 'freemium' propositions gives an opportunity to demonstrate value and foster engagement. A large, engaged customer base is an asset that can be monetized via the data they produce, the cross-sell opportunity they present, or the value they add to a company's prospects as an acquisition target.
- **Develop and pursue a sustainable commercial strategy.** Building a product that customers love and weave into their day-to-day lives is the key to growing and maintaining customer numbers, but valuations are dependent on long term revenue potential. Consider where value is created for users or third parties and whether the economic model is sustainable in a way that ensures fair customer outcomes. Will the business ever make money on a stand-alone basis or is the value only realized by aggressive repricing or via merger or acquisition? If the customer proposition is built on transparency and trust, how does this align with the sustainable commercial model? At what point is it attractive to exercise the optionality of getting a banking licence to retain the full economics of cross-sell?

A FRENCH CASE STUDY: AGGREGATORS AND THE "LIFE COACH" MODEL

Account aggregators are relatively mature and popular in France:

- Bankin' and Linxo, the two leading independent aggregators, claim to have approximately 3 million users between them
- Internet bank Boursorama acquired and integrated Fiducéo, an aggregator with personal financial manager
- Société Générale, Credit du Nord, Banques Populaires, and Caisse d'Epargne permit their clients to access third-party banks through their apps
- Crédit Mutuel Arkéa launched MAX, aimed at providing a simple, impartial and effective response to the needs of consumers' daily lives, including beyond financial services
- BPCE has reached an agreement with Meniga to launch new personalized financial coach services
- ING's money management platform (Yolt) with 300 K registered users in the UK is expanding to France and Italy
- Emerging Freemium models, such as Nestor+ by MAIF and Plus and Pro offerings by Bankin', offer a broader range of services and use cases

CONCLUSION

Incumbent banks have developed trusted brands, convenient footprints, and a strong franchise over many years, despite a relatively undifferentiated set of value propositions in competitive terms. As these historic advantages dissipate in the face of a changing customer mentality, incumbents will have to focus on customer experience and delivering value to customers, as well as managing their costs and monetizing pockets of value. This will require investment in proposition design, novel approaches to technology choices, and sharper pricing for customer value. Action is needed to sustain economics and be relevant for customers which will be the core of profitability in decades to come.

Neo-banks are trying to disrupt a business model that has changed little in many decades while other industries have been turned on their heads. Their ability to operate at such low costs may enable them to invest enough in customers to win market share. But until they are able to establish their brands in the mass market, maintaining their economics will be a balancing act. We see three main challenges for the neo-banks: generating widespread brand awareness and trust amongst an unengaged population; acquiring and activating sufficient customers to prove the concept; and developing a revenue model that is sustainable in the short term and paves the way for significant and defensible upside in the long term.

These more heavily regulated entities will have to contend not just with each other, but also with competition from other areas. Non-bank aggregators will seek to dis-intermediate by offering an independent aid to customers in exchange for a fee from the end user or the product manufacturer. By offering immediate value and asking the customer for little in return, they can build substantial clout by sheer volume of customers, provided that they sustain engagement and generate cross-sell. In contrast, technology giants already have the brand awareness, war chests, and the ability to cross-subsidize and derive synergies between financial services and their traditional revenue streams, should they wish to take up the challenge. Finally, reflecting on the accelerated pace of change of recent decades, it's hard to discount attempts by other players to make a play for a place in customers' financial lives – telcos, supermarkets, and other retailers have all shown an interest in the past.

For leaders of these businesses, it will be essential to:

- Grow a sustainable business with a large number of customers
- Establish recurrent direct and cross-sell revenue streams attractively priced for value
- Ensure costs do not start to scale disproportionately to the business's growth rate