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INTELLIGENCE REPORT

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DIGITAL BANKING

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DIGITAL BANKING

HOW BRANCHLESS BANKS AND THEIR FINTECH COMPETITORS ARE CHANGING THE MARKET

Information on:

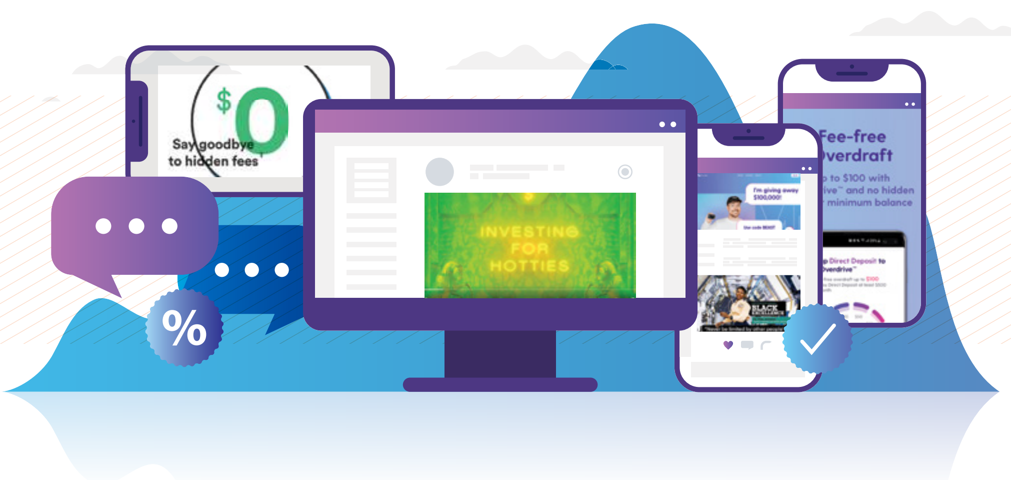
Top digital banks, banking platforms that have raised the most venture capital, customer acquisition costs, lifetime value, profitability, efficiency and more

Featuring interviews with leaders from:

Current, OakNorth Bank, Green Dot Corp., Citi Ventures and more

Case studies on:

Square, Chime, Current, GO2Bank, OakNorth Bank and Studio Bank



Dear Reader,

The largest bank in the United States, the $3.4 trillion global behemoth known as JPMorgan Chase & Co., hesitated to put a retail bank in the crowded and competitive United Kingdom in the past.

That changed in 2021. JPMorgan Chase CEO Jamie Dimon announced a digital retail bank with headquarters in London and a customer center in Edinburgh. But no branches.

International expansion was cost-prohibitive in the past, Dimon admitted, but the economics of banking have changed. Even the biggest U.S. banks, which haven't abandoned branches, know that.

"What we always said is we're not going to do retail overseas … I can open 100 branches in Mumbai or 100 branches in the U.K., and there's no chance I'd gain enough share to make up for the additional overhead," he said at a Morgan Stanley conference in June of 2021. "Digital changes that."

This shifting landscape means digital platforms hold a lot of promise for banks seeking to grow profitably. This report, sponsored by Nymbus Labs, will focus on these business models, return on investment and elements of success of digital-first banks and banking platforms.

Of course, terms such as neobank, challenger bank and digital bank get thrown around a lot these days. Some of the newcomers are chartered and regulated banks. Others are offshoots of a bank. Most are financial technology companies that rely on banks to access payment rails, compliance programs or deposit insurance. For simplicity's sake, we'll call them digital banks. Whether they are banks or just call themselves a bank, we'll include them in this report. The goal is to reveal how they are changing the banking marketplace.

Sincerely,

Naomi Snyder
Editor-in-Chief
Bank Director

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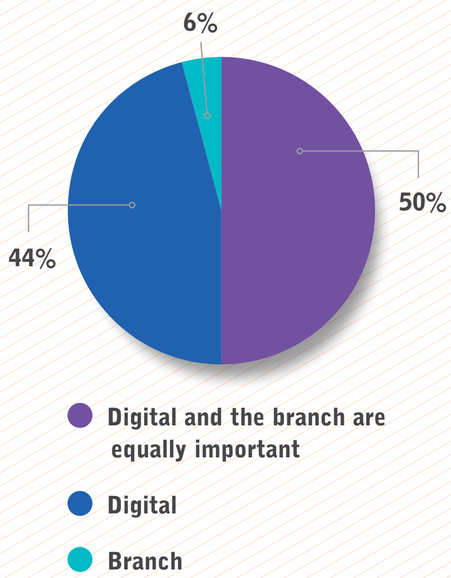
WHAT'S CHANGING

If your time to you is worth savin'
Then you better start swimmin' or you'll sink like a stone
For the times they are a-changin'
— Bob Dylan

Which delivery channel is more critical to your bank's growth strategy?



Source: Bank Director's 2021 Technology Survey

More than 300 digital banks, payments, budgeting and lending platforms have opened their doors in the last 20 years. Some of the branchless banks and banking platforms that sprouted up are now gone, such as Simple and JPMorgan Chase & Co.'s Finn. Others, such as Moven and BankMobile (now BM Technologies) are among those that simply morphed into something else. And some of them grew to become powerful rivals to banks, such as Square.

Now, branchless banking has entered a new phase, brought on by the pandemic. Digital banking accelerated during the Covid-19 crisis when customers and their bankers were stuck at home. With bank branches temporarily shuttered, more customers gravitated toward digital channels because they had no choice.

At the same time, banks have accelerated their spending in digital channels. In Bank Director's 2020 Technology Survey, sponsored by CDW, 65% of respondents said their bank implemented or upgraded technology as a result of the pandemic. The following year, 44% said the digital channel is the most important channel to the bank's growth, an increase from 38% two years prior.

"Over the last year, a lot of bank CEOs and boards have woken up to the fact that they haven't spent much money or time thinking about how technology is going to impact their business during the next decade," says W. Kirk Wycoff, managing partner at Patriot Financial Partners and a longtime private equity investor in the bank space. "Necessity is the mother of invention."

In the background of all of this is a wider banking industry that is cutting branches.

The industry shuttered a net 2,451 branches in 2020, almost double the decline in 2019, according to S&P Global Market Intelligence.

That has combined with a surge in investor interest in digital-first banking, where branches play a minimal to no role in the business. Investors are funneling capital into startups across the globe that can harvest data to better understand their customers and upend traditional banking norms.

The digital banks of the past focused on products and services, like high-interest savings accounts or budgeting advice. Banks and financial technology companies founded in the last few years focus more on building digital communities based on customer affinities and ensuring their products and services fit the unique needs of the communities they serve.

Digital Banks and Their Offerings

The influx of investor cash into the space is truly phenomenal. Fintech has become a hot sector: One out of five venture dollars globally went to financial technology companies in the second quarter of 2021, according to the research firm CB Insights. Dollars raised in the first half of 2021 totaled $58.7 billion, exceeding the total dollars raised in all of 2020.

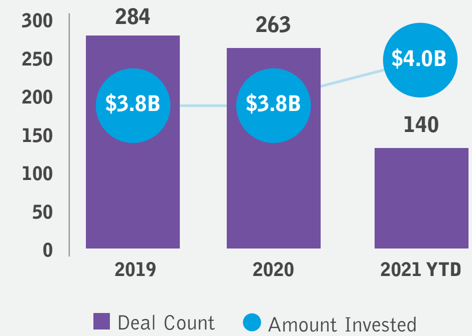
In the United States, venture capitalists love banking platforms, too. The banking, personal finance, credit card, commercial and consumer lending sectors raised $4 billion through July 9, 2021, more than the amount raised in the full year 2020 or 2019, according to the research firm Crunchbase. In total, $11.5 billion has been raised since 2019.

Of the top 10 banking and lending platforms that have raised the most venture capital money in the U.S., almost all are fintechs and only one is a bank (Varo Money). Chime is the No. 1 darling of venture capital, attracting $1.5 billion to date, according to Crunchbase.

More often, venture capital-funded banking platforms aren't banks at all, but financial technology companies that pay fees to banks in exchange for banking services, such as access to payment rails and compliance with banking regulations. But they look like banks to their customers.

And increasingly, they cater to a specific niche. Using a list of digital banks compiled by the Financial Brand and sponsored by Nymbus, Bank Director discovered that 67% of digital banks started in 2020 had a niche, up from 43.75% the year before and the highest percentage to date. The niches focus on a specific segment: small businesses or communities of "creatives,"

U.S. Digital Banking and Lending Venture Funding



Top U.S. Venture-Backed Banking and Lending Companies, by Overall Funds Raised

	Name	City	Total Venture Funding Raised
1	Chime	San Francisco	$1,542,603,117
2	Brex	San Francisco	$857,120,000
3	Circle	Boston	$711,000,000
4	Avant	Chicago	$657,900,814
5	GreenSky	Atlanta	$610,000,000
6	BlockFi	Jersey City, NJ	$508,681,673
7	Kabbage	Atlanta	$488,650,000
8	Varo Money	San Francisco	$477,400,000
9	MX Technologies	Lehi, UT	$450,000,000
10	Stash	New York	$426,250,000

Source: Crunchbase. Data as of July 9, 2021, contains companies on Crunchbase with the industry tags Banking, Personal Finance, Credit Cards, Commercial Lending, and Consumer Lending.
Venture funding includes seed, venture, corporate venture, and private equity for venture-backed companies.

A Sampling of Niche Digital Banks

gig workers or Black Americans. There's a digital bank for Muslims and one for environmentalists. There's a digital bank for doctors and another one for young doctors. There's a digital bank for venture capitalists and one for freelancers. There's one for the LGBTQ community. In the modern age, it's not so much the demographics that matter; it's identity.

"In some cases, these are big segments of the market, but they're not mass market," says consulting firm Cornerstone Advisors' Director of Research Ron Shevlin. "Nor are they geographically focused."

They don't necessarily want everyone. The bank for doctors doesn't need all doctors, Shevlin says. In some cases, they want a deeper relationship with the customers they do have.

"It's part of a bigger societal trend," says Liz High, executive vice president of Nymbus Labs, which helps companies develop digital niche banks. "Your choices used to be the big bank your parents used, or your local community bank or credit union; banks were just banks. It started with millennials, and it's super-amplified with Gen Z. You trust and choose companies that you relate to emotionally and reflect your values. Banks are no exception. It is why we are seeing a significant growth in niche, affinity-based financial services businesses."

When branches no longer have the same value, strong brands may fill the gap. Brand is not so much about marketing spend and logos. It's about the experience that customers connect with, High says. Brand experts now are asking themselves: "How do we make a consistently emotionally engaging experience?" she says.

Digital banks and platforms are challenging traditional banking in other ways, too. Digital banks often target groups they view as being neglected by the mainstream banking industry, such as consumers with low deposit balances or small businesses.

In Professor Clayton Christensen's famous book, "The Innovator's Dilemma: The Revolutionary Book That Will Change the Way You Do Business," he writes that start-ups target a piece of the market that's been neglected by larger, incumbent companies. Ironically, unprofitable customers make up the bulk of the startups' target market, the customers the incumbents don't care about. The startups offer services that are better and cheaper, attracting customers and growing until they really do take market share from the incumbents, who sometimes don't know what hit them.

In that same way, digital platforms often pick customers that incumbent banks ignore because they're not seen as profitable. The last 10 years of financial technology have exemplified this model, over and over again. "It's rare for such a strategic framework to play out so many times and for me to live it each time," says Arvind Purushotham, managing director and global head of venture investing at Citi Ventures, a subsidiary of Citigroup that invests in startups. Citi Ventures currently has investments in small-business focused fintechs BlueVine and Square, among others.

Digital banks solve a pain point in the market, an overlooked need.

Banks tend to take small businesses and consumers for granted, says Bradley Leimer, a former director of innovation for Santander Bank in the U.S. who consults financial technology companies and funders as part of Unconventional Ventures. Helping low- and middle-income America save and invest isn't a focus for most banks. Neither do most banks help small businesses grow. "Business creation is really the way of wealth in many cases; you're not seeing banks really help people build out their own small businesses," he says.

That's where some of the digital banks come in. The ones for small businesses cater their products and services for that niche, like easy, digital invoicing and payments management. Digital banks targeting low-income consumers cater their products to their needs, like fee-free overdrafts and paychecks that arrive two days early.

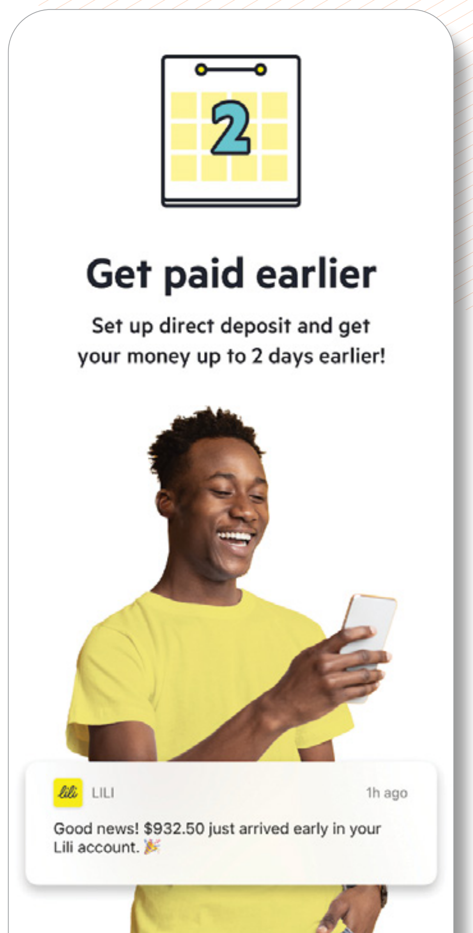
Instead of focusing on the mass market, digital banks and platforms offer unique products for unique segments. "What customers want is a better product, not simply a digital bank," Shevlin says. "They're not attracting customers because they're digital. They're attracting customers because they provide product capabilities that everybody else overlooked."

The new banks offer clues to where the industry is headed in an age with fewer physical locations but more focus on niche branding. Paying attention to their offerings is important to understanding the competitive landscape in the digital age.

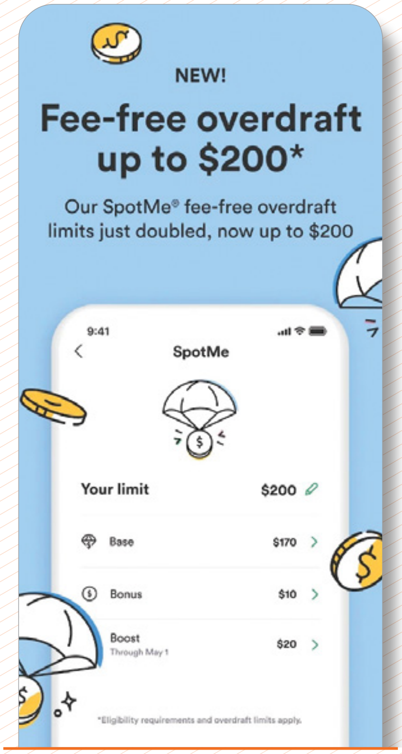
"They're not attracting customers because they're digital. They're attracting customers because they provide product capabilities that everybody else overlooked."

Ron Shevlin, director of research at Cornerstone Advisors

Source: Lili



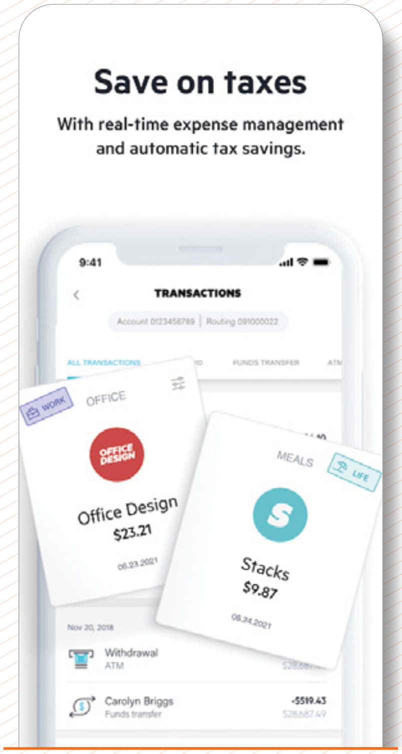
DIGITAL BANK AND FINTECH OFFERINGS



CHIME

Financial technology company that brands itself as "banking that has your back"

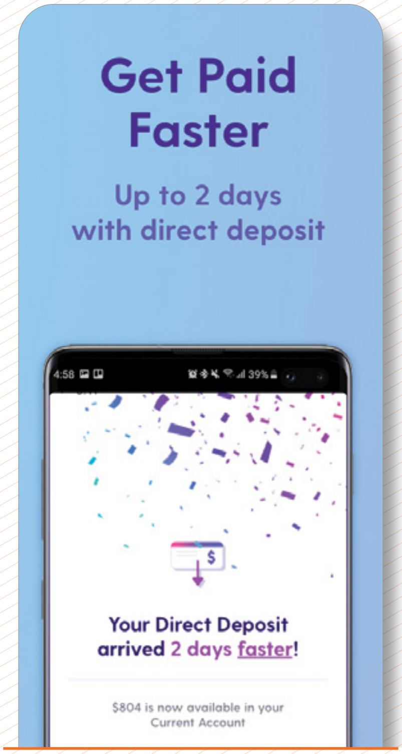
- Fee-free overdrafts up to $200 for customers who have monthly direct deposits
- Paycheck up to two days early
- No minimum balances, no monthly fees and no foreign transaction fees
- Automatic savings features
- Pay and receive payments instantly



LILI

A financial technology company for freelancers

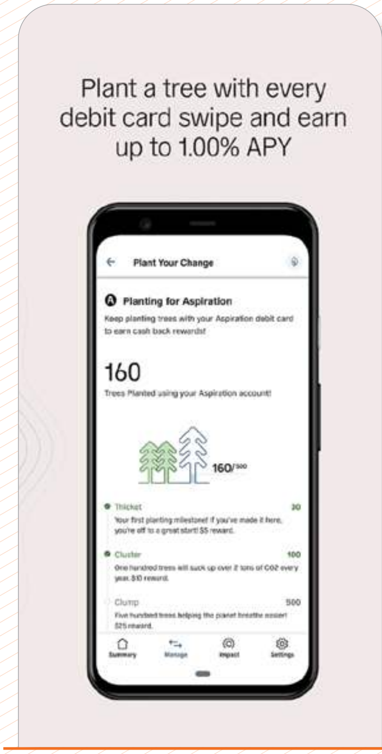
- Keeps track of deductible expenses via the app
- Automatically sets aside a percentage of income into a "tax bucket"
- Generates yearly and quarterly expense reports, helping gig workers and others avoid spreadsheets and cumbersome accounting software programs
- No monthly fees or minimum balances



CURRENT

A financial technology company for young adults, teens and their parents

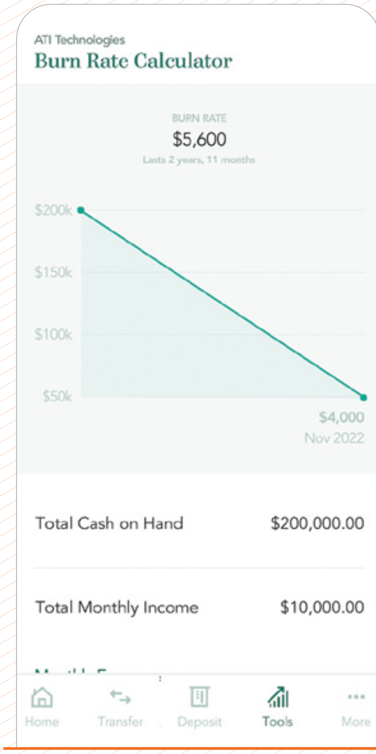
- No overdraft fees, monthly fees or minimum balances
- Get paid up to two days early
- $4.99 monthly fee for "premium" accounts allows customers to overdraft up to $100, earn rewards on purchases and have gas station holds on their debit cards instantly removed
- $36 per year for teen accounts includes budgeting, instant money transfers between parents and teens, chores to complete and instant spending notifications for parents
- Ability to pause debit card directly in the app



ASPIRATION

An SEC-registered broker dealer that brings a sustainable and communi-ty-oriented brand for banking, credit, debit card and investment services

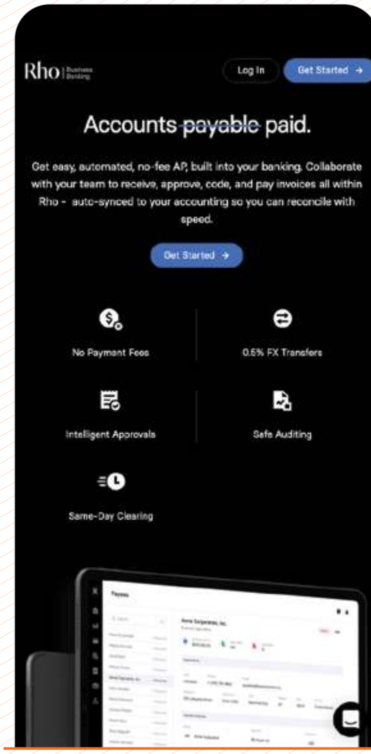
- Tree planting rewards
- Carbon dioxide offsets when you buy gasoline
- Opportunities to donate to charities
- Get paid two days early
- "Pay what you think is fair" fees
- Fee-free ATM network



GRASSHOPPER BANK

A subsidiary of federally chartered Grasshopper Bancorp that targets venture capital firms and their portfolio companies

- Forecasting and tracking tools
- Allows for multiple users
- Free banking for life includes domestic and international wires and ACH



RHO BUSINESS BANKING

Financial technology platform that caters to businesses with fee-free banking, global payments, corporate cards, AP and treasury management

- Free accounts payable software and accounting integration
- Up to $75 million in FDIC-insured deposits via the Rho Treasury Management Account
- Fee-free global USD payments and 0.5% FX rate
- Up to 1.75% cash back with no-fee virtual and physical corporate cards

CHALLENGES AND OPPORTUNITIES

Which digital banking service/branchless bank(s) do you currently have an account with?
Respondents were asked to select all that apply.
Sample Size: 324

Source: S&P Global Market Intelligence, 2021 Mobile Banking Survey

Of course, digital banks came on the scene long before the niche banking trend appeared. The platforms that have been around long enough to build a significant national brand tend to be older, such as Chime, which was founded in 2014, and Ally Bank, a subsidiary of Detroit-based Ally Financial, which has been around since 2000.

USAA's roots predate the advent of the personal computer and was one of the first digital-only banks in the United States. It survived by focusing on its core customers, active and retired members of the military and their families. But others innovated and then disappeared, such as budgeting neobank Simple, which was bought by BBVA USA Bancshares in 2014, and shut down in 2021 with that bank's acquisition by PNC Financial Services Group.

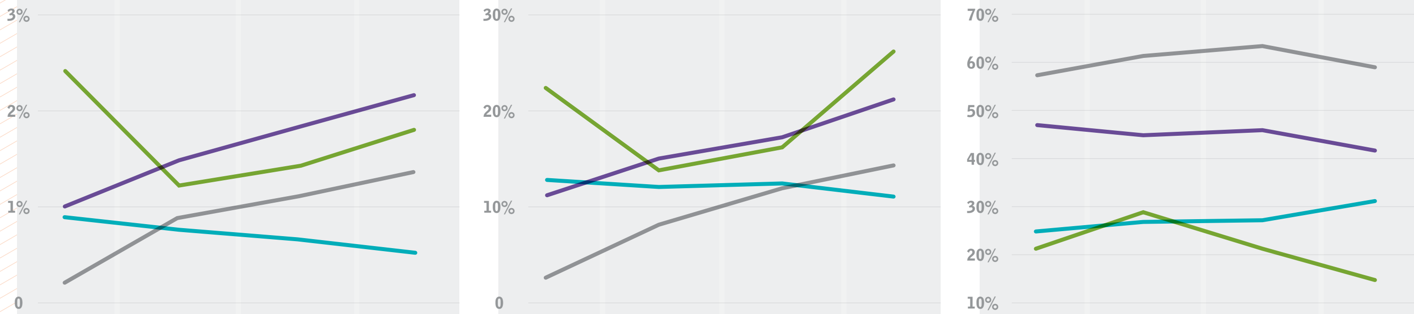
The German neobank N26 pulled out of the United Kingdom in 2020 a couple years after its launch as it reportedly struggled to acquire new customers in an already saturated market, writes Forrester Research's Senior Analyst Zhi-Ying Barry, responding to emailed questions.

Profitability, of course, is key to long-term sustainability, but that doesn't mean all digital platforms are focused on that. Globally, in fact, the Boston Consulting Group was only able to identify 13 profitable digital challenger banks in the world, 10 of them in Asia, according to a June 2021 report.

Although many scoff at the valuations of unprofitable technology companies, it's true that some of them, such as Facebook and Amazon.com, invested heavily in growing their businesses and building market share before becoming profitable. Their investors didn't punish them for that fact. Amazon was public for six years before posting a profit. "The last five years have found that you don't have to be profitable to be a company," says Unconventional Ventures' Leimer.

Whether or not they're focused on profit, growing and scaling their businesses while turning customers into revenues are some of the chief hurdles for digital banks.

Profitability and Efficiency Ratios of Select Digital-Only Banks



	Return on Assets				Return on Equity				Efficiency Ratio			
	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2020	Q3 2020	Q4 2020	Q1 2021
Ally Bank	1.05%	1.51%	1.73%	2.07%	10.98%	15.44%	17.47%	20.85%	46.88%	45.19%	46.08%	41.87%
Charles Schwab Bank	0.91%	0.80%	0.77%	0.68%	12.90%	11.35%	11.48%	10.63%	26.70%	28.01%	28.97%	31.41%
Green Dot Bank	2.42%	1.25%	1.39%	1.87%	23.28%	13.09%	15.98%	25.98%	23.32%	30.33%	22.90%	16.15%
Industry Average	0.36%	0.97%	1.10%	1.38%	3.47%	9.46%	10.80%	13.73%	58.73%	60.58%	61.61%	59.96%

Source: Bank Director research using FDIC data

"Digital-only banks experience a number of challenges," writes Barry, "including a crowded market where they have to compete with already established big banks as well as other challenger banks, a lack of clear product differentiation, and many of them struggle to scale. Many also find it challenging to keep growing and achieve profitability fast enough."

While the financial results vary, these banks share some common advantages, first and foremost, the ability to scale new products and services quickly using a cloud-native architecture.

Cloud-based infrastructure, which provides for large-scale storage of data on remote, secure servers, allows tech companies and banks to process software updates daily, not every few months. The tech companies, in other words, can adapt quickly in the age of the internet, improving the customer experience in real time. They can also access large datasets to extract meaningful insights on their customers, as long as they have the staff to come to good conclusions. Those insights can fuel important updates, and products and services that cater to their specific customer base.

"It's hard to overemphasize how important that is," says Citi Ventures' Purushotham. "The agility that that gives you actually is a very powerful advantage for the upstart."

In Purushotham's view, financial services traditionally focused on products such as a mortgages or CDs. Now that financial products and services are delivered increasingly on mobile apps and websites, the customer experience delivered through their devices becomes part of the product offering. A superior and compelling experience also helps drive down the cost of acquiring customers. Viral social media networks help build the brand, as demonstrated through companies like Square and Current.

"I download a product, I use it, I send it to my friends and then it spreads," Purushotham explains. Initially, startups can acquire new customers at low costs. That translates into financial advantages in the business model, sometimes driving down the cost of acquiring a new customer 10 to 15 times, Purushotham says.

Leimer of Unconventional Ventures says he's seen investor decks where consumer-oriented deposit and payment platforms project as little as $20 to $40 to acquire a new customer, although such estimates may be unreasonable. Traditional banks range from $250 to more than $400, he says.

A business-oriented bank's customers typically cost more to acquire. A business bank without branches would be attractive for an investor if it could acquire a new customer for about $150, half the cost of a traditional business bank with branches, Patriot Financial Partners Managing Director Wycoff estimates.

The simplest way to calculate customer acquisition costs, or CAC, is to divide sales and marketing spend by the number of new customers acquired in the same period.

"Without expensive physical networks, digital-only banks have a lower cost base and can translate these cost savings into more competitive banking products and services for customers," Barry says.

As a company matures, the cost to acquire new customers on a national basis can rise, as getting from 1 million to 2 million or even 3 million customers requires sizeable sales and marketing budgets.

Consumer-oriented digital banks and platforms tend to drive

One Rule of Thumb to Judge Value in a Digital Bank

revenue and new customer accounts through massive marketing campaigns, including a sophisticated use of social media and influencers that get Gen Z's attention. Chime spends $60 million to $100 million per year on TV advertising, says Shevlin of Cornerstone Advisors. "Show me a community bank that spends anywhere close to that kind of money," he says. "You can't find one."

But investors don't look exclusively at CAC when determining where to invest fintech dollars. Purushotham says he looks at lifetime value of a customer, or LTV. If LTV divided by CAC is four to six times or more, that's potentially a good investment. He also looks to the payback period, the amount of time it will take to make a profit on those customers.

Shevlin also looks at the lifetime value of customers. If 100 digital-only customers have a lifetime value of $10 each, for example, it would be better to get 10 customers with a lifetime value of $1,000 each. For many investors, it's not the number of customers that matter, but the lifetime profitability of each one.

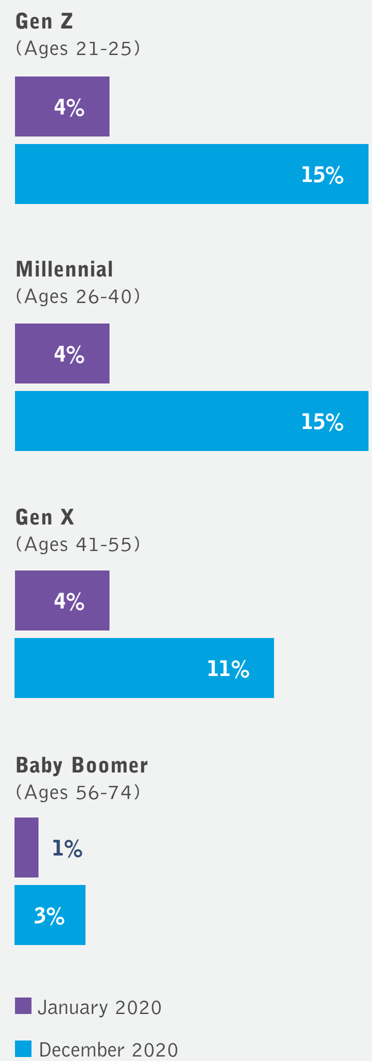
Once the digital bank or platform attracts customers, the big challenge is to make those customers bring in profits, of course. Banks that focus on consumers tackle this problem by ensuring customers make the bank their primary bank account. This is done with clever incentives that make it hard NOT to give the app a direct deposit of a paycheck every month.

Nearly a quarter of Chime customers say they chose the fintech as their primary bank because it offers two-day early access to their direct-deposited paychecks. Chime also offered early access to government stimulus and tax refunds, according to Shevlin's report, "Embedded Fintech." Others, such as Current and Aspiration, offer similar benefits.

In the past, digital banks have struggled to get primary checking accounts. But that seems to be changing. At the beginning of 2020, only 3% of U.S. consumers considered a digital bank to be their primary bank. By the end of the year, that had grown to 11%, according to the Cornerstone Advisors report, "Competing with Google Plex and Digital Banks: How Community-Based Financial Institutions Can Regain Their Mojo." A full 15% of Gen Z and millennial adults said at the end of 2020 that a digital bank was their primary bank.

Percentage of Consumers Who Consider a Digital Bank to Be Their Primary Bank

By generation



Source: Cornerstone Advisors surveys of U.S. consumers, Q1 2020 and Q4 2020

CASE STUDIES

Green Dot Corp.

Source: Green Dot Corp.

Green Dot is one of the oldest and most successful digital financial pioneers. It is highly profitable and offers banking products through partners such as Walmart, Uber Technologies and Amazon, plus a newly launched direct to consumer digital-only platform, GO2Bank.

In its newest phase, Green Dot continues to focus on low-income and unbanked customers while trying to provide unique financial products that help them manage their financial lives better. For example, GO2Bank offers its customers fee-free overdraft and access to their FICO credit score through a partnership with Experian. Its customer base often deals in cash, so GO2Bank offers deposit and cash services through its existing network of some 90,000 retailer locations such as Walmart.

Abhijit Chaudhary, general manager of Green Dot's direct-to-consumer business, says the only way Green Dot has been able to stand up new products quickly, in about a month's time, is because it doesn't have legacy technology like a traditional bank does, which drags out some product launches to eight to 12 months or more.

He estimates that Green Dot's entire company touches about 50 million people per year, which gives it a lot of data to understand its customers, their financial behavior and their needs.

Square

Source: Twitter @theestallion

Consider Square. The business payments company launched a consumer brand called Cash App in 2013, which became the No. 1 finance app in 2020, based on Apple and Google Play downloads. The app, which allows customers to send and store money for free, had 36 million active monthly users as of December 2020, meaning they're using the app at least once per month. That's up from 24 million in December 2019, a 50% increase in one year.

It's not just accounts that are climbing. So are profits. Square reported gross profit for Cash App at $495 million in the first quarter 2021, up 171% compared to the first quarter of 2020. The person-to-person payment capabilities are the loss leader for Cash App. Square doesn't make money from P2P. Instead, the company generates revenue through its prepaid debit card and other financial services such as bitcoin buying and selling, investing in stocks and exchange-traded funds, and cross-border payments.

Square has pursued a referral and social media campaign to generate interest, where celebrities like Megan Thee Stallion — known for hit songs like "WAP" and "Savage"— post videos about investing. These connections enhance Square's visibility with younger customers: More than 50 songs on the digital music platform

Spotify featured “Cash App” in the title as of mid-July 2021. At the same time, Cash App had 1.2 million followers on Twitter and 1.7 million on Instagram, and the hashtag #cashapp had more than 445 million views on TikTok.

Current

Current, likewise, has been on its own tear. Founded in 2015, it launched its first product in 2017 with a Visa debit card for teenagers and their parents. Today, the main source of the company’s growth is young millennials and Gen Z.

Promising no overdraft fees and paychecks up to two days early with direct deposit, Current has attracted 3 million accounts in 2021, up from 1 million the year prior. Adam Hadi, the fintech’s vice president of marketing, says that banks are “structurally” incapable of serving most Americans. Referring to the typical business model where banks attract deposits from the masses and lend to the creditworthy, he says that’s “a system by definition that can only serve a fraction of the population.”

Advertising messages on New York City subway trains reiterate that point: “We wondered, ‘what should banks stop doing?’ and started Current.”

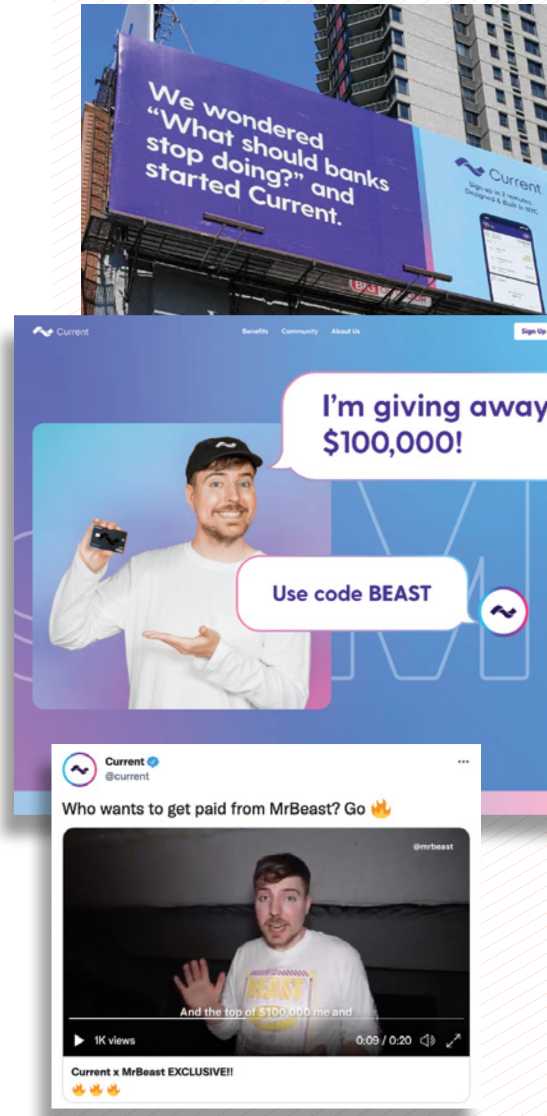
Current’s advertising also plays off the fact that there are no branches. “Did anyone miss bank branches during quarantine? We rest our case,” says one ad. “You never have to visit Current unless you want to work here,” says another.

Like Square, social media influencers have been a big part of attracting Current’s younger clientele, with an average age of 27 and earnings of about $45,000 per year. Current has a long-term exclusive partnership with MrBeast, a Gen Z phenomenon with 65 million subscribers on YouTube, to promote the banking app. He’s also an investor with Current, which makes him extra motivated. As of July 2021, MrBeast gave away $100,000 to 100,000 people on Current directly from his own account; he also picked five people who got an additional $1,000, says Hadi.

Current uses data to make decisions about products and services. For example, Current could see that its customers were getting hit with a lot of gas station holds on their debit cards. For someone living paycheck to paycheck, even a $50 or $100 hold for a few hours or a few days can be damaging, Hadi says. So, Current instantly removes those holds for its premium customers.

Data, Hadi says, informs everything that the company does. “It allows us to know what to build, what matters to folks,” he says.

Current’s business model has attracted investors. Although Hadi didn’t say whether Current is profitable, he did say the platform is in growth mode. It was impressive enough for Andreessen Horowitz to lead a $220 million Series D round for the company in April 2021, tripling its value to $2.2 billion in just five months, Hadi confirms.



Source: Current

Source: Instagram @ bankgreenwood

Greenwood

Greenwood is another banking platform that has attracted venture capital support, but this time to help Black and Brown communities. Its name recalls Tulsa's prosperous Greenwood District, a Black community that was destroyed by a white mob in 1921.

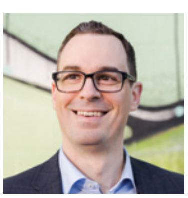
Founded by hip hop star Michael Render, aka Killer Mike, and a group of other prominent Black investors, the financial technology company raised $40 million in Series A funding in March from six of the seven largest U.S. banks and financial companies, including Bank of America Corp., PNC and JPMorgan Chase.

They're funneling money to a company "whose mission is core to our brand," wrote Greenwood President and Chief Technology Officer Aparicio "Reese" Giddins Jr., in an email. "It's part of our DNA to speak directly to Black and Brown communities who have been historically underserved by financial institutions, and that mission is key to how we approach our business, our products and our brand."

And this so-called challenger bank isn't really challenging banking. The platform introduced a program to share technology advice, co-branded cards, interchange fees, and deposits and loans with Black-owned banks as a way to support their operations.

As of publication, Greenwood hadn't launched yet, but had over 550,000 people on a waiting list. "When I saw the accounts start pouring in," Render said in an interview in early 2021 for *Bank Director* magazine. "I was like, 'Wow, now people are getting it.'"

Studio Bank



Aaron Dorn, CEO and chairman, Studio Bank

The economics of local commercial banks are fundamentally different, of course.

Take Studio Bank, which got started in 2018. Billing itself as a bank for "creators" in the heart of Nashville, Tennessee, Studio Bank is banking literally on Nashville's reputation as "Music City." But the bank is as enthusiastic about serving entrepreneurs and business leaders of all sorts, even real estate developers, among its more than 2,500 customers.

The bank's business model and its branding are built on the concept of networking and connections, hiring bankers who have decades of experience in town serving industries such as music, nonprofits, technology and real estate. Its diverse advisory board and board of directors include industry titans such as gospel star CeCe Winans, the chairman and CEO of Warner Music Nashville, John Esposito, and developer Pat Emery. At Studio Bank, you can get a loan from someone who once played on stage with country singer Barbara Mandrell, for example.

"One of the best parts of our value proposition ... [is being] intentional about the fact that if you bank with Studio Bank, we will be a networking partner for you. We will help you get to know other people in your industry or outside your industry," says CEO and Chairman Aaron Dorn.

Those connections worked. The bank set out to raise $40 million but ended up raising $46 million in 2016 and 2017. After two years focused on growing deposits and loans, it was profitable by the fourth quarter of 2020 and remained so in the first quarter of 2021.

Studio Bank sponsors local events and organizations. It set up a modern website where it prominently displays its mascot, a French bulldog. It also has a podcast and a Spotify playlist. But while other banks might focus their online presence on their products, like savings and checking accounts, CDs, or loans, Studio Bank focuses on "empowering creators" and the feeling that becoming a customer of the bank is becoming part of a supportive group.

Dorn honed his ideas about brand as senior vice president, chief strategy and marketing officer with another local bank, Avenue Bank, which sold to Nashville-based Pinnacle Financial Partners in 2016. Avenue Bank ditched tellers in favor of relationship bankers and once had a guitar you could play in the lobby. It still had branches, but it represented a different idea of what a bank could be.

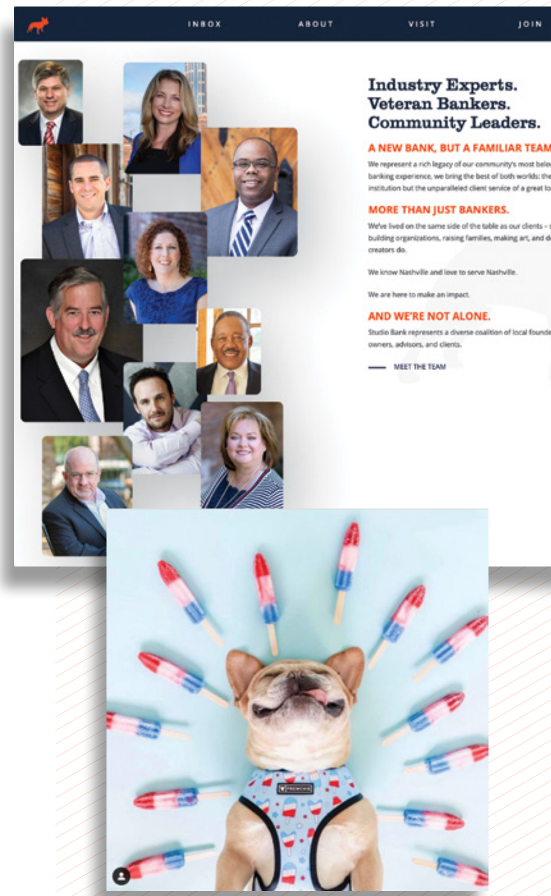
At Studio, "brand is a significant focus for us only because we want to represent who we are to the world, and represent that well and accurately and in an engaging manner," Dorn says.

Dorn is not against branches. The bank just doesn't have any, sticking with a small office downtown. It's a bank without branches but not without humans. You're not going to have to call a 1-800 number or talk to a bot, the bank promises. "We want to have the modern technology platform that rivals the biggest banks, but at the same time, use a local, personal touch," he says.

There's not a lot of whiz-bang needed to have better technology than most local banks, Dorn admits. Having a mobile banking app with the same functionality on the phone as the desktop already is a step above many, he says. Business owners can essentially run their businesses using their phone with access to treasury management tools through the mobile app, for example.

"There's probably a dozen little ways our features combine for a very elegant and intuitive user experience that is also beautifully designed," Dorn says. The bank's motto is: "Local, social, digital, human." So far, it's working.

STUDIO
A BOUTIQUE BANK



Source: Studio Bank

OakNorth Bank

Ben Barbanel, head of debt finance, OakNorth Bank

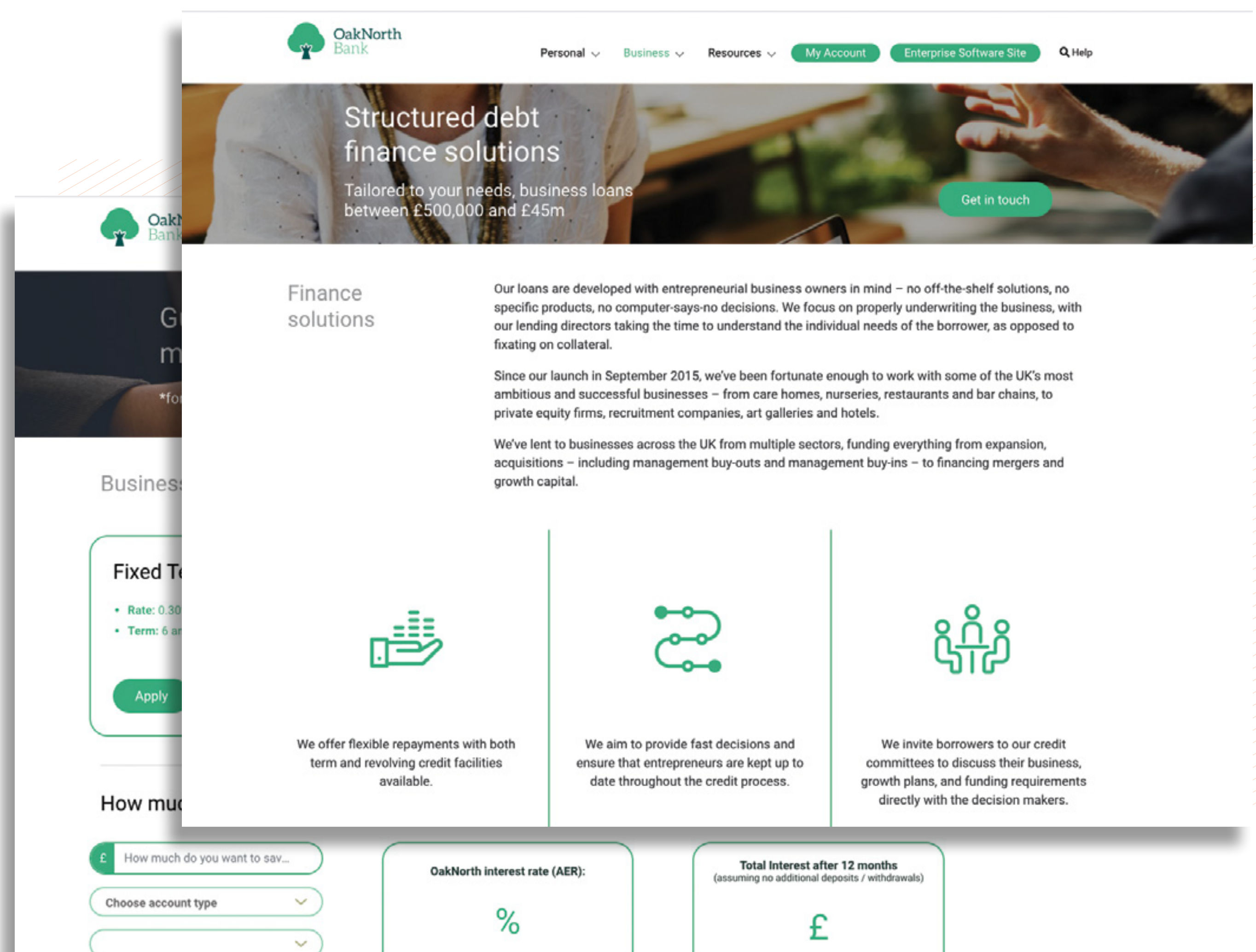
Another digital-only bank that is profitable is London-based OakNorth Bank.

The U.K. bank has no branches, had its first full year of profitability within two years of its launch in 2015, and caters to what it calls the "missing middle," growth businesses in the small-to-medium sized range that often struggle to get financing from banks.

The fact that OakNorth is efficient is an understatement. It had a 29% efficiency ratio, known as a cost-to-income ratio in the United Kingdom, in the fourth quarter of 2020, according to its 2020 annual report. Big banks in the U.K. typically have cost-to-income ratios in the 60% range, says Ben Barbanel, head of debt finance for OakNorth Bank.

He attributes that to a relentless focus on cost control. The focus dates back to OakNorth's earliest days. Barbanel remembers getting a call from his boss, OakNorth co-founder Joel Perlman, in 2015. Perlman asked Barbanel to meet at one of London's swankiest hotels, Claridge's. When Barbanel got to the hotel, he asked the doorman for help, but the doorman had no idea who Perlman was, nor did

Source: OakNorth Bank



he seem to have a reservation at the hotel. It turned out Perlman was working from a couch near the elevator.

"I asked him, 'What are you doing?'" Barbanel recalls. "He said, 'What do you mean what am I doing? It's great here. Nobody bothers you. Nobody asks you if you want a cup of coffee. It's a free lounge, and I can tell people I'm working in Claridge's.'"

Barbanel says the story illustrates the cultural frugality of the organization, which helped the startup break even after nine months. "We don't have any branches, and we don't believe in that model," he says. "That's highly capital intensive, both in terms of real estate costs, rent, heating, lighting, staffing, etc. We don't believe in that."

OakNorth also doesn't try to be all things to all people. It has a relentless focus on its customers, who are primarily focused on getting answers quickly on their loan applications. OakNorth Bank will notify a customer within 24 hours whether it's interested in a loan. Borrowers generally have an answer within five to seven days after the loan application enters underwriting, Barbanel says. "I would say 80% of our transactions, we do have a time critical element to them, so that really appeals to a lot of our clients," he says. The bank lends to U.K. businesses with annual revenues equivalent in U.S. dollars of about $5 million to $80 million.

But data is one of the essential elements that sets OakNorth apart from traditional banks, Barbanel believes. Using information from a variety of sources, it developed predictive models of credit quality for the industries and geographies it serves, rather than looking just at historical figures, such as a business financial statement. For the restaurant sector, OakNorth might look at online reservation data in real time, for example, as well as average receipts, spend per head and other factors to determine the health of that restaurant and the sector going forward.

"Typically, the major banks would look at very much backward-looking, historic data, and there'd be some arbitrary forecast numbers that wouldn't really get interrogated in much detail," he says.

Predicting the future is always difficult. Throw a pandemic into the mix, and you might just throw in the towel on predictive analytics. But Barbanel remains optimistic. The Financial Times reported OakNorth had loan defaults worth $100 million during the pandemic, partly from a luxury hotel developer, but none have resulted in a loss, he says. The bank reported profits before taxes of £77.6 million in 2020, up from £65.9 million in 2019.

"We don't have any branches, and we don't believe in that model. That's highly capital intensive, both in terms of real estate costs, rent, heating, lighting, staffing, etc. We don't believe in that."

Ben Barbanel, head of debt finance for OakNorth Bank

SUCCESS CHECKLIST

FIVE ELEMENTS OF SUCCESS FOR DIGITAL-ONLY BANKS

1. Superior technology

Digital-first banks and platforms rely on cloud-native technology to quickly stand up new products and services to meet customer needs as well as real-time access to data. In the this model, the quality of the digital services is part of the product's value.

2. Unique products that serve a niche customer base

"If you don't solve a particular paint point extremely well, it's hard to acquire customers at a low cost," Citi Ventures' Purushotham says. "When you think about Chime, when you think about Robinhood, when you think about many of these leading, at least, consumer-facing players, it turns out that that's actually an important aspect of it … Maybe it doesn't serve everybody. It doesn't serve high net-worth individuals. But it serves [that] 20-something person with a single paycheck that needs to do certain things but never wants to go to a bank."

3. Scalability

"So, your first product was a success," Purushotham says. "Or maybe your second was a success … So do you continue that magic that you hit in the first or second product?" At some point, your competitors start imitating the successful startup, as happened when Robinhood Markets introduced commission-free trading. Now, the incumbent wealth managers such as Vanguard Group, Fidelity Investments and a host of others offer it, too.

4. Sustainability

One of the more important aspects of a successful digital bank or banking platform is not just scalability but sustainability. And a big part of that is compliance. Digital lenders generally pay for compliance through partnerships with banks. Some in recent years have decided to become banks, such as Varo and Social Finance (SoFi), in part to control their product offerings and scale up without sharing revenues with a bank partner.

"So, when you're operating in financial services, whether it's in payments or lending, not only are there compliance and regulations, but you fundamentally want to run a safe and reliable operation because people are trusting you with their private information, with their money and with things that they normally don't do with other digital entities," Purushotham says.

5. Experienced leadership

Closely related to the idea of sustainability is, of course, the importance of the founders and management team. Purushotham wants to invest in companies that have strong leaders at the helm. "We pay a lot of attention to how those CEOs and the management teams think about it, how mature they are in their thinking about regulations, and about complexities that arise in the financial services world," he says.

> “If you don’t solve a particular pain point extremely well, it’s hard to acquire customers at a low cost.”

Arvind Purushotham, managing director and global head of venture investing at Citi Ventures

Conclusion

Although there are some similarities between building a traditional bank and digital bank, the economics of banking have changed substantially where digital banks can achieve what wasn’t possible years ago. Cloud-native architecture, a niche focus and superior products and services can drive efficiency and high profitability. The key is to think like a brand: Put customers first and deliver highly personalized digital banking solutions and experiences.

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About Nymbus Labs

Labs is an innovative marketing support agency inside Nymbus that helps institutions compete in new niche spaces with technology, strategic marketing and user-experience expertise. Collaboratively, Nymbus and Nymbus Labs enable banks and credit unions of any size to grow and attract new market segments by delivering a full suite of banking technology along with the operational resources to launch and run a new digital bank. Whichever growth path you choose, Nymbus buys back decades of lost time and accelerates your ability to engage and support the entire customer journey.

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DIGITAL BANKING

HOW BRANCHLESS BANKS AND THEIR FINTECH COMPETITORS
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