# Better Banking:

**How challenger banks support sustainable growth, opportunity, and resilience across Britain – and how Government and regulators can enable them to do more**

INNOVATE FINANCE

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# Overview

The UK is seen as the leading global centre for innovation in finance and technology. A pillar of this success has been the rise of UK 'challenger banks', which have flourished within a robust and supportive regulatory environment and bring significant benefits to customers, the UK economy and wider society.

This paper sets out those benefits and discusses how policymakers and regulators can support future development of the sector to boost growth in both the FinTech and banking markets.

This paper has been jointly produced by Innovate Finance, the industry body for FinTech (including challenger banks) and Hogan Lovells, whose Financial Services practice is recognised in the market for the specialist knowledge, their pragmatism and creativity, combined with a strong awareness of the market and risk, their understanding of the regulatory and business landscape (including funding structures, commercial and corporate transactions) and for their forward-thinking, problem-solving approach, in consultation with Innovate Finance's cohort of challenger bank members.

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# Introduction

Challenger business models are based on digital banking services powered by state-of-the-art technology, centred on the customer experience, and providing customers, who value convenience and ease of use, with seamless digital experiences, intuitive mobile apps, and enhanced customer service.

Challenger banks bring a wide range of benefits in three key areas which assist overall policy objectives.

1. **Customer experience:** Retail challenger banks focus on customer experience and underserved market segments. They offer easier access to financial services for underserved, unbanked, and younger customers. In addition to supporting financial inclusion and education, their services help households manage cost of living pressures. They have established better payment journeys for consumers with the effective use of Open Banking and the creation of 'pots' to help with budgeting. Challenger banks have also led the way in passing on interest rate rises to savers.

2. **Financing small and medium-sized enterprises (SMEs):** Challenger banks now provide more finance to SMEs than the 'big-five' established banks. According to the British Business Bank data, challenger and specialist banks provided 55% of SME lending in 2022. As a result, challenger banks underpin SMEs who form the bedrock of UK economic growth, trade, and job creation. Challengers also supply SMEs with tools essential for them to meet UK Net Zero goals.

3. **Competition:** Innovative digital banks compete with the incumbent banking providers, which stimulates innovation and improves their productivity and customer service (and that of other financial services players), while increasing business investment. Challenger banks also stimulate competition by providing new forms of wholesale banking services. Challenger clearing banks are the first new payment clearing banks in 250 years. They initially focussed on servicing start-ups and FinTechs; now traditional financial institutions, such as wealth managers, credit unions and even government, seek their services.

This paper reflects the views of Innovate Finance members who are stand-alone digital-first or digital-only challenger banks, holding a UK banking licence. Our definition of 'challenger bank' excludes digital banks that are part of established groups and non-digital providers of specialist finance.[1]

*1. The Innovate Finance members who contributed to the paper all hold a banking licence, with the exception of one e-money institution, which is applying for one. There are currently 14 challenger banks. The initial pioneers such as Starling, Atom, Monzo and OakNorth have been followed by firms such as Zopa, Allica, Oxbury, ClearBank, Tandem and Bank of London. New digital challenger banks have continued to enter the market.*

# Summary

## *Challenger banks support sustainable growth, greater competition and deeper resilience, and can help deliver more for policy objectives*

### Driving customer experience to a new level

**Challenger banks champion a customer-centric approach.**

- Generate new solutions to meet customer needs not addressed by established banks
- Led the market in offering great savings rates to consumers and SMEs as base rates rose, putting pressure on high street banks to follow suit
- Top retail and SME customer satisfaction surveys
- Help people manage the cost of living
- Embrace digital banking and open banking to benefit customers
- Enable customers to understand and take control of their finances and borrowing

### Providing a critical source of finance to the SME sector

**The SME sector accounts for 99% of all businesses in the UK employing a substantial portion of the workforce - 50% of private sector jobs.**

- Challenger banks provide 55% of all small business lending in the UK
- Gain SME market share by innovating to compete with incumbent banks
- Support SMEs and other customers to achieve UK Net Zero goals

### Increasing competition and innovation in the banking sector

**Challenger banks provide new services and embrace technology and innovation, which spurs competition in the UK banking sector.**

- Drive others to improve their service
- Compete in wholesale banking markets and offer "banking as a service"
- Provide new payment clearing services for a new generation of customer-facing FinTechs
- Reduce barriers to entry for SMEs
- Embrace and diffuse new technology in the banking sector
- Offer new high-value jobs in the UK banking industry and FinTech sector, many outside London and the South East
- Support international expansion

## *Government and regulators can enable challenger banks to do even more by focussing better on how regulatory issues affect the challengers*

### Think Challenger Bank first

**Purpose-led challenger banks are often better placed to help to help with wider economic and societal policies, including policies for:**

- Net Zero and tackling climate change;
- Economic growth and SMEs; and
- Stronger society: Creating opportunity and financial well-being.

Policy makers often make a bee-line to the Big Banks to help with wider economic and societal policies, overlooking the digital first, purpose-led challenger banks that are better placed to help.

### Apply proportionate prudential regulation

**Avoid an unnecessarily heavy regulatory burden for challengers which would hold back the benefits that they provide to the economy and society. For example:**

- **Simplify MREL requirements on challenger banks to enable them to lend to more SMEs:** Consider aligning the bail-in threshold to the proposed deposit threshold in ring-fencing reforms.
- **Remuneration:** Allow options to reduce the need for huge salaries that challengers can't offer and help them to compete with US firms.
- **Deposit protection:** Increase FSCS limits so challenger banks can provide further competition for savings, without imposing the cost of prefunding FSCS on challenger banks.
- **Current UK proposals will materially reduce SME lending capacity of challengers.**

  The UK should:

  – Strip out PRA gold plating of Basel and apply a proportionate regime to non-systemic banks.

  – Increase bank levy threshold to enable challengers to re-invest more of their profits into growth.

### Apply a challenger impact and competition test to avert unintended consequences for these banks

**Test how new policies and regulation will impact challenger banks and avert unintended consequences.**

- **Apply a non-big bank lens to focus on:**
  – Competitive implications;
  – Regulatory implications for non-bank payment institutions and technology firms as well as challenger banks; and
  – Unintended consequences for harm to competitiveness.

Current issues include:

- **APP fraud** - More than 70% of Faster Payments scams originate on tech platforms. Yet banks are picking up the cost of reimbursing victims, which could cost challengers 10% of revenue. Government should look to see how Big Tech firms can contribute to reimbursement and take more action to stop crime.
- **Relaxing ring-fence rules** - Might have an unintended competition impact on challengers.

# Why are challenger banks successful in the UK?

Challenger banks have emerged since the global financial crisis partly as a response to customer dissatisfaction with traditional banks, due to, for example, high fees, limited transparency, and lack of personalisation. Other challenger banks have entered the payments clearing market, offering essential payment clearing services that enable the new generation of customer-facing FinTechs. The incumbents have also gradually moved away from some sectors (such as the area of SME lending) due to the higher capital requirements they attract post global financial crisis which leads to low returns.

Using innovative digital technology and unburdened by the legacy systems and complex organisational structures of the big banks, challenger banks have been able to design systems and processes to meet customer needs better and more efficiently. Their tech-driven, customer-centric business models are agile and capable of adapting rapidly to changing customer needs, launching new features, and offering innovative financial products. They can also respond more easily to evolving regulatory priorities, such as fairer treatment of customers, as embodied in the new Consumer Duty.

The UK's regulatory approach has also been an important success factor (including the regulatory sandbox). Regulators have encouraged innovation and competition in banking subject to sound risk management and governance and culture that ensures an operational focus on consumer protection and fairness.

We describe in more detail the reasons behind the attractiveness of the UK for challenger banks.

## 1. How do challenger banks benefit the UK?

### 1.1 Drive customer experience to a new level

(a) Challenger banks undertake a customer-centric approach focussed on delivering personalised services and building relationships with customers, which provides:

(i) Greater and simplified access to banking services for people who may have been excluded from traditional banking services, including those with poor credit history, those on low incomes, and those who live in rural areas;

(ii) Increased efficiency with new technologies and processes that result in enhanced services and enables cost savings for banks and better prices for customers; and

(iii) Greater transparency about fees and charges, which has led to greater trust and confidence among consumers.

(b) Challenger banks generate solutions that meet customer needs not addressed by established banks, such as providing:

(i) Easier banking, particularly for the digitally-confident;

(ii) Support to customers in the cost of living crisis by empowering customers to better understand their financial data and providing them with access to innovative, data-first, technological solutions tailored to their individual needs; and

(iii) Tools to help customers build their borrowing power, understand their credit history and track savings to take control of their day-to-day budgeting and long-term financial goals.[2] In particular, challenger banks help younger generations to engage with their finances and plan for the future.

(c) Better customer satisfaction:

(i) Faster delivery of better savings rates following recent Bank of England (BoE) rate rises;

- As UK high street banks come under attack from regulators and MPs from the Treasury Select Committee for offering "measly" rates on easy access savings accounts, challenger banks have seen an influx in customers due to their higher saving rates.

- In early July 2023, the top five largest banks (i.e. HSBC, NatWest, Barclays, Lloyds and Nationwide) offered rates between 0.9% and 1.75%. In contrast, challenger banks offered much higher rates of 3.25% or more, with Atom leading the pack by offering 3.95% on easy access accounts.[3]

- The Financial Conduct Authority (FCA) *Cash Savings Market Review 2023* noted that digital challengers appeared to increase their on-sale savings rates faster and to a greater degree than some of the Big 9 banks, particularly on easy access accounts: *"In January 2022, the median easy access rate on offer from digital challengers was 0.4% higher than the Big 9. As of July 2023, this gap has grown to 1.7%."*[4]

(ii) Challenger banks Starling and Monzo have consistently topped the Competition and Markets Authority's (CMA) twice-yearly customer satisfaction surveys (see Tables 2 and 3); and

(iii) Challenger bank digital models are also well placed to take advantage of and drive the consumer benefit enabled by Open Banking. For example, Monzo uses Open Banking to help small businesses get paid faster.

(iv) The FCA noted in January 2022 that two digital challenger banks (Starling and Monzo) alone rapidly grew their market share to 8% of personal current accounts (often as an addition to a customer's main account) by offering easy account opening processes and innovative mobile apps that have improved customer experience.[5]

## 1.2 Provide a critical source of finance to the SME sector

(a) Challenger banks, not the incumbent large banks, are now powering the UK's small businesses, including many start-ups. In 2022, challenger and specialist banks provided 55% of SME bank lending, and lent £35.5 billion, exceeding lending by the major UK banks for the first time.[6] The trend suggests that incumbent banks will continue to reduce their exposure to SME lending due to capital allocation decisions influenced by Basel III. As a result, challenger banks will need to be provided the capacity to service increased demand.

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*2. The Innovate Finance report on Cost of Living includes many examples of how challenger banks are helping their customers: www.innovatefinance.com/reports/fintech-helping-with-the-cost-of-living/*

*3. www.cityam.com/challenger-banks-win-customers-on-back-of-better-savings-rates-than-big-boys/*

*4. www.fca.org.uk/publication/multi-firm-reviews/cash-savings-market-review-2023.pdf See in particular the chart in figure 4 on page 14 of the report.*

*5. FCA Strategic Review of Retail Banking Business Models - Final Report: www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-final-report-2022.pdf*

(b) The role of challenger banks in supporting SMEs is fundamentally important to the UK's economy and productivity.

(i) SMEs make up 99% of all businesses in the UK, employ a substantial portion of the workforce - 50% of private sector jobs, and are critically important in supporting UK supply chains, and generating job opportunities across multiple sectors and geographical regions.

(ii) Challenger banks were a critical source of finance to the SME sector during the coronavirus pandemic. The FCA highlighted that they remained open to new businesses during the pandemic while larger banks were not accepting new customers. This allowed customers to apply for loans under schemes such as the Coronavirus Business Interruption Loan Scheme (CBILS)[7] which was pivotal in enabling many SMEs to weather the pandemic.

(c) Challenger banks have gained SME market share by providing:

(i) Faster loan approval combined with flexibility on lending criteria, forms of collateral and tailored loan terms;

(ii) Competitive rates due to lower overheads;

(iii) Access to clearing for start-ups and new FinTechs that are outside of the risk appetite of high street banks;

(iv) Access to innovative lending solutions (for example, invoice financing and supply chain finance) that enable SMEs to get funding faster and more easily); and

(v) Greater access to lending for the commercial real estate, residential real estate and buy-to-let (BTL) sectors.

(d) OakNorth provides a good example of the scale of challenger bank support for SMEs and the impact on the economy. Launched in September 2015, OakNorth has lent over £9.7 billion to UK growth businesses, directly contributing to the creation of 40,000 new jobs and the construction of 28,000 new homes across the UK.

(e) Challenger banks also support SMEs and other customers to achieve UK Net Zero goals by providing them with accessible, affordable and innovative tools to identify Net Zero impacts, set priorities and access to finance for transition.

(i) These include plug-in tools for retailers and payment services firms that measure emissions and link emissions with spend, thereby enabling small firms to refine their supply chains and finance the change.

(ii) Challenger banks such as Allica, OakNorth and Oxbury are active members of Bankers For Net Zero. Oxbury is leading work on helping to reduce greenhouse gas emissions in agriculture, Tandem is focussed on helping households reduce their carbon footprint, while Starling, Monzo and OakNorth are signatories to the Tech Zero commitments.[8]

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6. www.british-business-bank.co.uk/press-release/challenger-and-specialist-bank-lending-reached-record-high-of-35-5bn-in-2022-finds-latest-british-business-bank-research/

7. *FCA Strategic Review of Retail Banking Business Models - Final Report:* www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-final-report-2022.pdf

### 1.3 Increase competition in the UK banking sector

(a) Challenger banks provide consumers and small businesses with improved services, lower fees and charges, and better customer experience than traditional banks which stimulates competition. They also compete in wholesale banking markets.

(b) Innovative new entrants incentivise established players to improve their offerings and their operations to remain competitive.

(c) Challenger banks are also competing in wholesale banking markets, for example by providing banking services to other regulated firms. Challenger banks pioneered the concept of "banking as a service". Under this arrangement, a challenger bank provides Financial Services Compensation Scheme (FSCS) protected payment accounts to the customers of other payment service providers, extending the range of financial services that can be offered by non-banks. This reduces barriers to entry for retail banking services and increases competition.

(d) Some challenger banks, such as ClearBank, Starling and Bank of London, have entered the payments clearing market, offering payment clearing services that enable the new generation of customer-facing FinTechs. As the first new payment-clearing banks to come to market in 250 years, they provide fresh competition to established clearing banks. Initially the challenger clearing banks provided payments clearing to start-ups and FinTechs, but now traditional financial institutions, such as wealth managers, credit unions and even government services, increasingly seek the efficiencies that they offer.

(e) Challenger banks diffuse new technology in the banking sector which has helped place the UK at the forefront of the digitalisation of financial services. By embracing new technologies such as Artificial Intelligence (AI), machine learning, and biometric authentication, challenger banks drive the adoption of new technology and build a fertile ecosystem that nurtures wider change in financial services.

(f) Innovation creates new high-value jobs in the UK banking industry, new specialist roles in the FinTech sector and supports international expansion. Many of these jobs are outside London and the South East. For example, Starling is based in Cardiff, Southampton and Manchester; Atom is based in Durham; Tandem is based in Blackpool; Monzo has significant operations in Cardiff with its workforce dispersed across the UK; Allica's main headcount is in Milton Keynes; Oxbury is based in Chester; and OakNorth has considerable operations in Manchester.

(g) The FCA's *Strategic Review* notes that digital challenger banks' provision of new services, embrace of technology and innovation have spurred competition in the UK banking sector. They have caused a ripple effect which has helped improve choice and outcomes for many customers and businesses as traditional players strive to remain competitive by adopting digital innovations to improve service quality.[9]

## 2. What is the secret of Britain's attractiveness for FinTech start-ups and challenger banks?

### 2.1 The UK remains an attractive location for FinTech start-ups and challenger banks, offering:

(a) A well-established regulatory framework for financial services, which provides a level of certainty for FinTech start-ups and challenger banks;

*8. https://techzero.technation.io/*

(b) Active and involved regulatory bodies that have introduced several initiatives to encourage innovation in financial services, including the regulatory sandbox and the innovation hub;

(c) A thriving FinTech ecosystem, with a number of venture capital firms and angel investors willing to invest in FinTech start-ups and challenger banks. The Government has also introduced several funding initiatives to support the growth of the FinTech sector, such as the FinTech Growth Fund and the Fintech Delivery Panel;

(d) A sizeable talent pool, with a highly skilled workforce with expertise in areas such as technology, finance, and regulation as well as marketing and customer service skills;

(e) A large and diverse consumer and business market, which provides a significant opportunity for FinTech start-ups and challenger banks to grow and expand their customer base; and

(f) An ideal location for challenger banks looking to expand globally.

### 2.2 Specific policies and regulatory changes have helped challenger banks grow including:

(a) Open Banking and the Payment Services Directive were catalysts for UK financial services innovation, along with changes to payment and bank rules which now allow non-banks to directly access payment schemes.

(b) The increase in the FSCS since 2007 has increased retail consumer confidence in the security of their deposits in any bank.

(c) The CMA's work on banking competition helped ensure a more competitive market following the consolidations of the global financial crisis.

(d) In the SME market, the British Business Bank's matched capital programme (which sits alongside loan guarantees) and the opening of Government loan guarantees to challenger banks helped level the playing field.

(e) Some regulatory changes in response to the banking crisis, such as the ring-fencing rules, also had a secondary effect of helping competition.

## 3. What can UK policymakers and regulators do to enhance Britain's attractiveness and help challenger banks thrive?

There are five main ways that policymakers and regulatory bodies could encourage challenger banks to flourish more strongly in the UK:

### 3.1 Think challenger! – recognise better prudential regulatory issues specific to challenger banks

(a) Governments tend to consider the interests of the 'big-five' incumbent banks as synonymous with the "UK banking sector".

(b) We recommend that all future UK banking regulation should include a 'challenger bank test': a specific assessment of implications for challenger banks, digital business models and their customers. This should not be a 'one-size-fits-all' approach and should recognise the diversity of challenger-bank business models. Where appropriate, waivers should apply.

*9. FCA Strategic Review of Retail Banking Business Models - Final Report: www.fca.org.uk/publication/multi-firm-reviews/strategic-review-retail-banking-business-models-final-report-2022.pdf*

(c) As challenger banks now support swathes of UK businesses and consumers and have become a permanent part of the economic landscape, they merit better representation in formulating regulation. The diversity of their business models also reduces systemic risk and increases financial stability but this also means that regulators need to be attuned to the variety of challenger-bank business models.

(d) Our members wish to see a regulatory regime that is prudent and risk-aligned for banks and payment firms, while being competitive. Fortunately, the Prudential Regulation Authority (PRA) has full discretion on capital and liquidity requirements for domestic, non-systemic banks. However, there are important examples of a challenger-bank perspective being missing and the consequences that follow.

(i) PRA proposals on Basel 3.1 could put challenger bank lending to the SME sector at risk. The PRA consultation on the implementation of the Basel 3.1 standards, expected "very small increases" in capital requirements for SME lending. Instead, our analysis showed that SME lending is likely to see a jump of over 30% in regulatory capital requirements under the Standardised Approach, which would put at risk challenger bank provision of credit to the SME sector. Such an increase in regulatory capital requirements would either reduce the supply of credit or raise its price.[10]

(ii) The thresholds for MREL ("minimum requirement for own funds and eligible liabilities" which are required to recapitalise a failed bank) are set in terms of asset levels and transactional volumes relevant for legacy business models. The transaction thresholds are not suitable for scalable digital business models which can have high transaction volumes at low risk. The consequence is that a growing challenger bank hits a regulatory cliff-edge that triggers unnecessary additional capital and convertible debt requirements, which discourages growth and reduces lending capacity especially for SMEs (as an EY study on MREL explains, estimating that the impact of MREL will reduce SME lending by £42bn - or 20% of lending - over 5 years).

### 3.2 Encourage competition and growth

(a) We recommend that a 'competitive implications lens' be formally applied by the PRA and the FCA to regulation and supervision. This should be a wide-angle lens that considers regulatory implications for non-bank payment institutions and technology firms as well as challenger banks. In particular, this should include explicit assessment of unintended consequences for harms to competitiveness.

(b) The PRA's secondary objectives are to facilitate competition between firms and in the markets for their services, and to promote growth and international competitiveness.

(i) Regulators should show greater sensitivity to areas of 'super equivalence' or 'gold plating', both in relation to the UK's adoption of the Basel rules and to the EU's implementation. Examples include removal of the Support Factor for SME lending in the UK, which is retained in the EU. There is a danger of UK regulation making challenger banks (who use

*10. To illustrate the scale of impact: one challenger bank's well-established pricing model indicates a 100bp to 160bp increase in its lending margin over base rate (the average margin is currently 350-400bp). Other members have indicated that their lending margins over base rates will also have to increase as a result of these changes. For more information: Innovate Finance response to the PRA consultation (CP16/22) on the "Implementation of the Basel 3.1 standards": www.innovatefinance.com/consultation/pra-consultation-paper-cp-16-22-implementation-of-the-basel-3-1-standards-innovate-finance-response/*

the Standardised Approach) uncompetitive with firms that branch in from the EU with less onerous capital requirements. Similarly, UK MREL thresholds should be competitive with EU thresholds.

(ii) Remuneration rules should be modified. This is a key issue for pre-public challenger banks who face an unlevel playing field for talent including Independent Non-Executive Directors because they are bound by strict limits on remuneration, but compete against:

- Incumbent banks who overcome limits by paying significant cash bonuses in-year and higher fixed pay.
- Tech firms who face no limits when they compensate for long-term value creation with stock options.
- Financial services firms without a banking licence who have no restrictions on awarding stock options.

(iii) HM Treasury (HMT) proposals on ring-fencing could also have a knock-on effect, given that the ring-fencing requirements for large banks have, indirectly, helped promote competition.[11]

(iv) In terms of competition, there is also scope to reform and improve the effectiveness of the current SME lending bank referral scheme.

(v) The prospect of the BoE increasing the limit for guaranteed deposit protections above the current £85,000[12] must be done in a way that does not create additional costs of pre-funding FSCS. While raising protections is welcomed as it increases the safety net for customers, it should not diminish the capacity of challenger banks to lend, invest and remain competitive.

(vi) Regulatory changes may have unintended consequences for challenger banks. For example, regulation of interchange fees has an unintended consequence on bank competition as challenger banks benefit from being 'card acquirers' and controls on fees can therefore reduce one source of income for challenger banks. However, wider consideration on consequences ought to also be given to other FinTech and financial services verticals.

### 3.3 Streamline regulatory processes for challenger banks

(a) The regulatory environment, which is created with legacy players in mind, can be complex and time-consuming for new challenger banks, particularly in the early stages of development.

(i) The Strong and Simple regime, currently under consideration, is an excellent start. However, the piecemeal introduction of this regime makes it difficult for challenger banks to plan their financial requirements. The resulting uncertainty around projected costs and regulatory requirements can have a major impact on investors' willingness to invest, and, therefore, on a challenger bank's ability to grow and develop.

(ii) The slow pace of policy changes compounds these effects, which means that potential benefits arrive too late for challenger banks who must deal with today's regulatory burden.

*11. Innovate Finance response to HM Treasury Call for Evidence on "Aligning the ring-fencing and resolution regimes": www.innovatefinance.com/consultation/hm-treasury-call-for-evidence-aligning-the-ring-fencing-and-resolution-regimes-innovate-finance-response/*

(iii) Oversight and regulatory reporting are designed for larger banks which creates an unnecessarily heavy burden for challenger banks, who have simpler business models and fewer resources.

(b) We recommend that:

(i) The UK Government should require regulatory bodies to streamline/consolidate the rules that apply to banks during their early years (for example, aligning and clarifying the threshold criteria that determines the extent to which various regulatory regimes apply).

(ii) Proportionate oversight and tailored reporting should be required for new and growing banks, particularly where their business models are simple, transparent and straightforward.

(c) We fully support the joint programme between the FCA and BoE to transform data collection. The recommendations could be transformative for challenger banks: to transform data collection and standards; make improvements to reporting instructions; improve landing pages; and, standardise classification. The timely delivery of this initiative, which is ambitious and strategically important in striking a better balance between the costs and benefits of regulatory reporting, will help reduce the burden of regulatory reporting for challengers.

### 3.4 Modify proposed approach to deal with payments fraud

(a) Industry is concerned about the way criminal gangs, hostile states and scammers have been targeting UK consumers to make fraudulent payments. This is highly distressing and damaging to consumers and also impacts our FinTech industry. The Payment Systems Regulator (PSR) is introducing a mandatory reimbursement regime for Authorised Push Payment (APP) scams and fraud, which is the first of its kind in the world. We recognise that it is important for consumers to be adequately protected against increasingly sophisticated APP scams and fraud as they cause consumer harm and distress. However, current proposals to tackle APP fraud will disproportionately hit FinTechs including challenger banks (as sending and receiving parties in payments) forcing such firms to bear disproportionate costs and risk significant damage to competition in the sector.

(b) The mandatory reimbursement regime, alone, is expected to wipe out – at a minimum – a tenth of FinTech firms' revenue.[13]

(c) Such costs pose a material barrier to market entry and adversely impacts start-up and scale-up viability in the UK market, overall, negatively impacting the international competitiveness of the UK as a place to do business.

(d) We also note that the PSR's regime and implementation schedule focus on remediation rather than prevention, with an absence of clear prevention guidance or standards under which to better protect customers and their businesses. This risks creating misaligned incentives. In our view, remedial measures (i.e. reimbursement) should be balanced with preventative standards and measures for firms. Without this, FinTechs and other banks will be forced to block or slow payments, negatively impacting customer experience and diminishing the benefits of the Faster Payment Service (FPS) that was seen as a UK world-leading, real-time payments rails.

12. www.ft.com/content/d86303a7-d1fe-4625-b478-6f28ce0734a9

(e) We also think there should be a fairer attribution of responsibility (i.e. social media, technology and telecommunications firms stepping up too). More than 70% of all APP scams originate via tech platforms and a further 18% of scams originate on telecoms networks[14], and our members note that the vast majority of APP scams reported to them are cases of purchase scams. These purchase scams are driven either through paid-for advertisements, or user-generated content on social media marketplaces, which advertise fraudulent goods and services. We are concerned that the liability for dealing with APP fraud is being disproportionately weighted towards the UK FinTech sector, without full appreciation of where online fraud originates.

(f) Government should look to see how Big Tech firms can contribute to reimbursement costs. As the House of Lords Fraud Act 2006 and Digital Fraud Committee argued about the current liability burden placed on the financial services industry, *"the last link in the fraud chain…cannot be expected to foot the fraud bill alone".*

(g) Stop Scams UK has brought together challenger banks and payment firms, telecom companies and 'Big Techs' such as Google and Meta to coordinate systemic action to tackle scams.[15] This now needs leadership from the Government with clear Ministerial accountability and active management, tasking of regulators and agencies, and convening or even mandating of industry providers.

### 3.5 Refine fiscal measures

(a) The Bank Corporation Tax Surcharge[16] was introduced following the bailout of banks in 2008 and had nothing to do with challenger banks.

(b) The rate was reduced and the threshold was increased from £25 million profits to £100 million, which is welcome and appreciated, but it still impacts on challenger banks' ability to achieve and maintain profitability, which is critical to support future growth and provide confidence to investors.

(c) As it is an unfair burden and disproportionately constrains challenger bank growth, we recommend a further increase in the threshold to £250 million or special relief for challenger banks.

*13. Based on data points drawn from Innovate Finance members and the wider FinTech ecosystem.*

*14. www.ukfinance.org.uk/system/files/Half-year-fraud-update-2021-FINAL.pdf*

*15. stopscamsuk.org.uk/about-stop-scams-uk*

*16. The Government has confirmed that the Bank Corporation Tax Surcharge will be cut from 8% to 3% alongside the increase in Corporation Tax rate from 19% to 25%. From April 2023, banks are charged an additional 3% rate on their profits above £100 million.*

# A to Z of leading challenger banks

**Allica Bank**
Allica Bank is the UK's only digitally-native challenger bank committed to providing a full-service banking relationship to established SMEs.

**Offices located in:** Milton Keynes, London & Manchester
**Banking licence awarded in:** 2019

**Atom Bank**
Atom bank is the UK's first app-based bank, on a mission to make the experience of borrowing and saving faster, simpler and better value than anyone else.

**Offices located in:** Durham & London
**Banking licence awarded in:** 2015

**ClearBank**
ClearBank is a purpose-built, technology-enabled clearing bank and through its banking licence and intelligent, robust technology solutions, enables its partners to offer real-time payment and innovative banking services to their customers.

**Offices located in:** London, Bristol & Amsterdam
**Banking licence awarded in:** 2016

**Monzo**
Monzo is the bank that lives on your phone with a mission to make money work for everyone and an ambition to build the one app customers turn to to manage their entire financial lives.

**Offices located in:** London, Cardiff & San Francisco
**Banking licence awarded in:** 2017

**OakNorth**
OakNorth supports and empowers "the Missing Middle" – businesses with £1m-£100m turnover that have been overlooked and underserved by traditional financial services – providing them with the data, insights, products and services they need to succeed and scale.

**Offices located in:** London, Manchester, Bristol, Birmingham, Newcastle, Leeds, East Anglia & Glasgow
**Banking licence awarded in:** 2015

**Oxbury**
Oxbury is the only UK bank dedicated to British agriculture, providing British farmers and food producers with the lending they need to run their farm businesses and savings accounts to any individual or business that wants to back British farmers and UK agriculture.

**Offices located in:** Chester
**Banking licence awarded in:** 2020

**Starling Bank**

Starling Bank is an award-winning, fully-licensed and regulated bank built to give people a fairer, smarter and more human alternative to the banks of the past, offering personal, business, joint, euro and dollar current accounts alongside a children's card.

**Offices located in:** London, Cardiff, Manchester, Southampton & Dublin
**Banking licence awarded in:** 2016

**Tandem**

Tandem, as the UK's greener, digital bank, is on a mission to help the UK transition to a lower carbon lifestyle, calling this banking for a greener future.

**Offices located in:** Blackpool, Cardiff, Durham, London & Manchester
**Banking licence awarded in:** 2018

**Zopa Bank**

Zopa Bank is the tech unicorn that raised over $500 million from the early investors of Uber, Slack, and Alibaba to build Britain's best bank.

**Offices located in:** London
**Banking licence awarded in:** 2020

# Appendix

**Table 1: Jobs growth within challenger banks***

| Jobs growth created within challenger banks* | |
|---|---|
| **Year** | **Total jobs** |
| 2015 | 228 |
| 2019 | 3,400 |
| 2022 | 7,700 |
| ***source:** Data analysis by The Data City https://thedatacity.com | |

**Table 2: Business banking service quality in Great Britain survey[17]**

| Business banking service quality in Great Britain survey* | | | |
|---|---|---|---|
| | | Question | |
| | | **Overall service quality:** We asked customers how likely they would be to recommend their business current account provider to other SMEs | |
| **Survey** | **Challenger Bank** | **Ranking** | **Percentage of satisfaction** |
| August 2023 | Monzo | 1 | 84% |
| | Starling | 2 | 82% |
| February 2023 | Monzo | 1 | 82% |
| | Starling | 1 | 82% |
| August 2022 | Monzo | 2 | 79% |
| | Starling | 1 | 83% |
| February 2022 | Monzo | N/A | N/A |
| | Starling | 1 | 86% |
| August 2021 | Monzo | N/A | N/A |
| | Starling | 1 | 89% |

* This independent survey conducted by BVA BDRC for the CMA asked approximately 1,200 customers of each of the 15 largest business current account providers in Great Britain if they would recommend their provider to other SMEs. This shows that the two digital challenger banks in the survey, Monzo (included since August 2022) and/or Starling, have topped the charts since August 2021.

17. www.bva-bdrc.com/products/business-banking-service-quality/

**Table 3: Personal banking service quality in Great Britain survey[18]**

| Personal banking service quality in Great Britain survey* | | | |
|---|---|---|---|
| | | Question | |
| | | **Overall service quality:** We asked customers how likely they would be to recommend their personal current account provider to friends and family. | |
| **Survey** | **Challenger Bank** | **Ranking** | **Percentage of satisfaction** |
| August 2023 | Monzo | 1 | 80% |
| | Starling | 2 | 79% |
| August 2022 | Monzo | 1 | 81% |
| | Starling | 1 | 81% |
| February 2022 | Monzo | 1 | 81% |
| | Starling | 1 | 81% |
| August 2021 | Monzo | 1 | 83% |
| | Starling | 2 | 81% |
| February 2021 | Monzo | 1 | 85% |
| | Starling | 3 | 82% |
| August 2020 | Monzo | 1 | 86% |
| | Starling | 2 | 84% |
| * This independent survey conducted by IPSOS for the CMA asked approximately 1,000 customers of each of the 16 largest personal current account providers in Great Britain if they would recommend their provider to friends and family. The two digital challenger banks in this survey, Monzo and Starling, have topped the charts since they were first included in the survey in August 2020. | | | |

18. www.ipsos.com/en-uk/personal-banking-service-quality

## Get in touch with us

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Innovate Finance is the independent industry body that represents and advances the global FinTech community in the UK. It supports and advocates for digital challenger banks. Its mission is to accelerate the UK's leading role in the financial services sector by directly supporting the next generation of technology-led innovators.

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The Hogan Lovells Financial Services practice is recognised in the market for the specialist knowledge, their pragmatism and creativity, combined with a strong awareness of the market and risk, their understanding of the regulatory and business landscape (including funding structures, commercial and corporate transactions) and for their forward-thinking, problem-solving approach. They are also known for having a large and stable team, with lawyers at all levels of seniority.

The practice is global and benefits from collaborating with financial services experts in the EU, US and Asia on emerging trends and on cross-border implementation projects and transactions.

They are market leaders for their Consumer Finance, Payments and FinTech practices as they have continuously been recognised as Band 1 in Chambers UK since 2015. Hogan Lovells was the first UK law firm to establish a practice dedicated to the FinTech sector, drawing on their strength in financial services regulation and technology law and building on their reputation for innovative legal thinking dating back to their ground-breaking work on the establishment of Zopa in 2004. The practice is overseen by a Global Steering Group bringing together partners and associates across the firm to discuss trends and co-ordinate our offering to clients. Their FinTech focus areas include (but are not limited to) banking/institutional infrastructure, collaboration agreements, blockchain and cryptocurrencies, consumer banking, crowdfunding, cybersecurity, insurtech, investment management, open banking, marketplace lending, payment services, regtech, remittances, Robo-advisors, smart contracts, VC, AI, NFT creators and exchanges, and securitisation.