Business

Anthony Hilton: No one is challenging these banks but they are in trouble

- ANTHONY HILTON
- Tuesday 10 December 2019 13:21
- 0 comments

Click to follow
The Evening Standard

Tech: Upstarts like Monzo have aggressive growth plans - but where are the customers coming from? *( )*

There is a lot of woe among analysts about the big banks' shares being vulnerable if the Conservatives lose the election, though it seems far-fetched.

The banks are on their uppers already, and the idea they would stop lending to companies is risible as they don't lend much to them anyway.

Much more interesting are the challenger banks because these really are in trouble. Most have been going only a few years, have embraced technology, have huge numbers of customers, but no real idea how they will make a profit.

Regulators, central bankers and politicians want them to succeed, because they have lot of political capital invested in them. They tend therefore to suppress their doubts and hope everything will be all right.

It is unlikely to be. Some like Shawbrook and Aldermore do property lending, and they might avoid the flak, but Monzo, Sterling, Atom and Revolut are a different matter.

Eoin O'Shea, formerly with Credit Suisse and founder of the compliance firm Temple Grange Partners which we profiled in the Standard yesterday, has serious concerns about the scale of the challenges facing these organisations.

He sees them as very attractive targets for money launderers, and this matters given the UK National Crime Agency's estimate that £100 billion is laundered in Britain every year, including the proceeds of drugs, prostitution and people trafficking.

It normally takes a challenger about 10 minutes to set up a bank account, enabling the likes of Monzo to grow to three to four million customers in a relatively short amount of time.

Traditional banks take much longer. They could do what the challengers do — they can get the apps after all — but they also want to double check the identities and motives of their potential customers face to face. That takes time. O'Shea says the virtual challenger model is especially vulnerable if corners are cut.

Also, while all the banks have some form of whizzy technology, they all have different systems and there is no independent central body to check whether the new tech is resilient, or to endorse the technical quality of any particular software.

Aircraft are not allowed to fly unless their systems are checked and rechecked by independent bodies in case they crash. The current Boeing incidents show what a big deal this is for the company when it all goes wrong.

The same could happen for banks because they are pushing the frontiers of technology.

But if one of them should crash, which is possible given fast growth and the commercial stress of a wafer-thin profit margin model, the taxpayer might ultimately have to bail out the customers to the tune of up to £85,000 each.

If there are millions of them that could be a lot of money.

What chance then that the regulator would have to appear before a Parliamentary Select Committee to explain how the bank was allowed to run such systems unchecked.

Surely it would be better to have a bank technology supervisor or some such to make sure these systems are robust so they don't fall over?

It is also interesting that Monzo has well over three million customers and says it plans to double its user base by the end of next year to six million.

But the established banks are not shedding anything like as many customers as these figures suggest, so where are these coming from?

Quoting from a December 2018 FCA report, O'Shea points out a tiny fraction, only around 2.5%, of UK bank customers actually switch bank accounts every year.

And 90% of those switches are simply a reshuffling of accounts between the top four traditional banks.

The implication is that the vast majority of new challenger customer accounts are actually secondary accounts.

This matters a great deal because the higher-margin business is in that primary account activity, so challengers are being forced to survive at the very thinnest edge of the profit wedge.

Banks have to lend money to have a chance of being profitable, but these loans require a lot of regulatory capital to make sure the bank can cover any possible losses.

The established banks know this; but the challengers seem not to. Metro got its capital allocations wrong and the shares have crashed in spite of raising a £350 million loan to shore up its balance sheet.

The other banks also have to put aside substantial capital for their loans, and the chances are they will need to borrow.

The City is awash with money and pouring it into loss-making ventures seems like a good idea at the moment. Until the mood changes and then they run for cover.

That is when the music stops, as it inevitably will at some point, and that is also when the challenger bank model will itself be challenged.

More about: | Business