The journey and implications of a banking license

With interest rates at a 15-year high and a mountain of consumers shopping around for the best place to move their money, there is a lot of additional revenue to be made in banking right now. Look also at Revolut, which has been the subject of widespread speculation surrounding its application for a UK banking licence. But, tempting as the rewards may be, a great deal hinges on making the right decision as to what level of licensing - and therefore regulation - financial institutions apply for. Making the wrong choice can be a costly and time-consuming error.

Whatever the activity, finance is a regulated industry, so complex approvals and oversight come with the territory, but a banking licence is by no means the only option out there. Electronic Money Institutions (EMI) and Credit Institutions also occupy the space on the fringes of banking and are often preferred by fintechs, especially at early stage, for giving the extra flexibility to manoeuvre and preserve their much-valued agility. The decision as to where to sit on the licensing spectrum is far from arbitrary - it establishes the scope of operations and shape of the regulatory journey for many years to come.

The definition of banking is 'the regulated activity of accepting deposits. This definition stipulates that, a) money received by way of deposit is lent to others or, b) deposits are used to materially fund a business line. So, the establishing question for a firm contemplating a banking licence is whether or not their business plans fall in line with that definition.

Banks are among the only industry category that can generate revenues from both sides of the balance sheet. A bank asset are its loans, its liabilities, that customer deposits earn interest from. The main benefit of becoming a bank is in owning your own balance sheet and, particularly in the present climate, this can equate to significant revenues. Fintechs like Monzo and Starling, that have made the transition have benefited. For the year ending in February 2023, Monzo's Net Interest Income grew 382% to £164.2 million. Starling also experienced a strong uplift in Net Interest Income from £121m to £348m.

On the other hand, an Electronic Money Institution licence authorises the holder to issue electronic money and enable electronic payment transactions without engaging in the full range of banking activities. As a result, it comes with a slimmed-down set of regulatory obligations.

Leveraging banking-as-a-service providers can also allow operators to earn interest on deposits but, typically, within a revenue sharing structure. Look at Wise, which operates with a payment license and has seen its interest income rise from £4m to £140m over the last year on deposits of about £10bn.

Successfully obtaining a banking license is not something one can bet on, there are defined rules and procedures to follow in the process and some precise implications following the receipt of one. We've tried to demystify the process in figure 1, and show some of the steps, requirements and implications in different developed market jurisdictions; also, some of the nuances and differences between markets. At Mouro Capital, we are fintech specialists and have helped many of our companies navigate regulatory licensing, whether for company build up or international expansion. In another article, we will look at emerging markets and the specific paths that two of our portfolio companies, Creditas and Klar, took to obtain banking licenses in Brazil and Mexico.

So, what are the key things to consider?

Process and timelines

In the UK, firms typically spend 12-24 months before even submitting an application, following which regulators take another six months to reach their determination. The process is similar in Europe, with a pre-application stage during which supervisors engage with the applicant prior to formally submitting for a licence. In the Euro area, the entry point for all applications is via the national supervisor of the country where the bank will be located. They and the European Central Bank (ECB) are then involved at different stages in the process, coordinating closely before the latter makes a decision to grant or not. Depending on the relevant national regime, requests for further information can often delay timelines significantly.

At the end of the process in the UK, the regulator will either grant a license or, in the case of firms that haven't yet fully developed their operational capabilities, go to a mobilisation stage. This allows the new bank up to 12 months to complete the remaining build-up. For example, in the area of governance, a fully-fledged banking licence recipient will have all key senior management roles in place and independent non-executive directors; an entity going down the mobilisation route will have a minimum of Board Chair, CEO and one other Executive, with other roles identified and ready to recruit. Regardless, all new and mobilising banks must meet threshold conditions and capital and liquidity requirements at all times.

In the US, the dual banking system means the regulatory landscape is fragmented. Banking licenses are issued at both the federal and state levels, with distinct requirements for each. Banks can choose to operate under federal charters (issued by the Office of the Comptroller of the Currency - OCC) or state charters (issued by state banking authorities). Different standards apply to community banks, which typically enjoy more flexible regulations, and national banks that are subject to stricter federal oversight.

Requirements

All application assessments follow a similar path, with regulators wanting to ensure how the business will be profitable, what risks their activities pose and how they are mitigated, key governance and organisational structures and risk management frameworks among other key points.

- Governance: Regulators typically assess whether a board has the appropriate composition, balance, independence, skills and experience necessary for its new banking role, also whether conflict of interest, management procedures and succession plans are in place.
- Owner and controller: A regulator will review the firm's controlling parties and ultimate owners, as well as their sources of funds, to assure they are fit and proper. In Europe, if the shareholders of the applicant entity hold more than 10% of capital or voting rights, or exercise a significant influence over the management of the entity, qualifying holding criteria will be applied. If there are multiple smaller shareholders, without qualifying holdings, the 20 largest shareholders will be assessed. As you might imagine, this is not without its complications: when looking at VC backed companies, for example, different classes of shares may have to be harmonised into some kind of common form, which late investors can perceive as giving up control or protection rights.
- Interpretative- vs. rules-based regimes: The degree of flexibility between adhering closely to a set of rules or interpreting broad principles, varies in Europe from market to market. As part of a compliance assessment, however, firms need to be able to show that they have done things in a certain way and that the internal culture is focused on customer outcomes.

Post license requirements and ongoing monitoring

Banks undergo regular stress tests, assessments and audits, ensuring financial stability and consumer protection.

- Cost of credit loss expenses allocation: Monzo said it had tripled its lending book, which, combined with higher interest rates on deposits, saw revenues more than double to £355m from the previous year. Yet Monzo's overall results were diluted by putting aside cash reserves of £101.2m to protect it from the increased risk of potential defaults on these loans. These reserves, known as credit loss expenses, were up from £14m a year earlier.

So, if to bank or not to bank is the question, these are the salient issues as we see them, but they're by no means exhaustive. The key to take away from this is that the decision is a defining moment for any operation.

Figure 1 - The process and requirements for obtaining banking licenses

	ELECTRONIC MONEY AUTHORIZATION	BANKING LICENSE	BANKING LICENSE (Germany used as a reference)	BANKING LICENSE Full-service national bank charter
BODIES INVOLVED	Financial Conduct Authority (FCA)	Prudential Regulation Authority (PRA) Financial Conduct Authority (FCA)	Federal Department for Financial Supervision of Germany (BaFin) European Central Bank (ECB)	Office of the Comptroller of the Currency (OCC) Federal Deposit Insurance Corporation (FDIC)
SCOPE OF ACTIVITIES	• Includes pre-paid cards and electronic pre-paid accounts • Execution of payment transactions • Services enabling cash to be placed on a payment account and related operations • Services enabling cash withdrawals • Others: Money remittance, account information services...	• Deposit taking • Issuing e-money • Investment-related activities • Others: Granting of credits, mortgages, insurance distribution...	• Deposit taking • Issuing e-money • Investment-related activities • Others: Financial Leasing, Payments services, Guarantees and commitments, Money Broking...	• Deposit taking • Lending services • Issuing credit cards • Investment services • Fiduciary services • Payment processing • Other (insurance, FX, branch services among others)
CONSUMER GUARANTEE	No guarantee	£ 85,000	The statutory deposit guarantee protects €100,000 per depositor per bank	The primary role of the FDIC is to insure deposits up to $250,000 per depositor, per insured bank for each ownership category.
PROCESS	Pre-application: Evaluating the optimum form of business structure and requirements, company registration, preparation of documents. Application: License submission. Post application: If approved, EMI is automatically added to the Financial Services Register with a Firm Reference Number (FRN). Written confirmation from FCA.	1. PRE-APPLICATION: ENGAGEMENT WITH REGULATORS TO PREPARE APPLICATION 2. APPLICATION: APPLICATION SUBMISSION WITH CORRESPONDING DOCUMENTS REQUIRED (EX: BUSINESS PLAN, AML POLICY, CVS...). 3. ASSESMENT: REVIEW BY CORRESPONDING AUTHORITIES OF THE PROPOSAL 4. DECISION: APPROVAL OF APPLICATION IF CONSIDERED. 5. FINAL APPROVAL: NOTIFICATION OF AUTHORISATION AND START OF ACTIVITY		
TIMELINESS	Between 3 and up to 12 months.	12-24 months for pre-application Between 6 and 12 months, following application submission	Up to 12 months (Article 15 of the CRD IV). However, current national laws may have different timelines	Usually within 4 months of receipt. Approval will expire if does not raise capital required within 12 months or commence business within 18 month
CAPITAL REQUIREMENTS	• EMI: Initial capital requirement of €350K • Small EMI: If average outstanding e-money is ≥ EUR 500,000, then minimum initial capital of 2% of average outstanding electronic money.	• A common equity tier 1 capital ratio of ≥ 4.5% • Capital Requirements - Based on CRD IV: €5m • Tier 1 capital ratio ≥ 6% • Total capital ratio of 8%	• A common equity tier 1 capital ratio ≥ 4.5% • Capital Requirements - Based on CRD IV: €5m. Some member states have higher thresholds.	• Common equity tier 1 capital ratio of 4.5% • Tier 1 capital ratio of 6% • Total capital ratio of 8% • Leverage ratio of 4%
ASSESMENT OF APPLICATIONS	EMI applicant must give details about: • Business plan. • Type of services provided • Governance arrangements and internal procedures and control mechanisms. • Measures taken to safeguard e-money holders' funds. • Initial capital at the level required by the regulations to start business. • people responsible for e-money and payment services businesses (if applicable). • details of anyone with qualifying holdings representing 10% or more of the capital or voting rights.	• Governance: Board should have the right composition, balance, independence, skills and experience • Business model analysis. • Risk management assessment. • Capital assessment. • Capital instruments assessment. • Liquidity assessment. • Owner/ controller assessment. • Recovery planning. • Orderly exit (solvent wind-down) and resolution.	• Quality and quantity of capital. • Organisational structure. • Governance Arrangement: Composition and role of the management and supervisory bodies, evaluation of their compliance with national law. • Internal control and risk mgmt framework: applied policies and methodologies.	The OCC considers whether the proposed bank: • has organizers who are familiar with applicable federal banking laws and regulations. • has competent management teams. • provides for sufficient capital in relation to the proposed business plan. • can reasonably be expected to achieve and maintain profitability. • will be operated in a safe and sound manner. • does not have a title that misrepresents the nature of the institution or the types of services it offers. • poses acceptable risk to the Federal Deposit Insurance Fund (if applicable). • demonstrates that its corporate powers are consistent with the purposes of the Federal Deposit Insurance Act (FDIA), the National Bank Act, and the Home Owners' Loan Act (HOLA) (12 USC 1464), as applicable.
POST LICENSE REQUIREMENTS	Notification of any changes on: • Responsibles of the management of the authorised EMI. • Qualifying holdings. • Agents, if their details change or if you cease dealing with an agent.	• Liquidity data to the PRA (ex: daily liquidity reports, weekly pricing data...) • Overall liquidity adequacy rule • Individual liquidity adequacy process	• Supervision held by BaFin and the competent Regional Office of the Deutsche Bundesbank. • If the institution is considered a *significant institution*, the ECB under the Single Supervisory Mechanism will be the supervisor.	The OCC supervises federally chartered banks through on-site supervisory activity and periodic off-site monitoring. • Significant Deviations After Opening • Expansion or Contraction of Assets or Activities • Change in Control • OCC Review of Management
PASSPORTABLE TO OTHER COUNTRIES	No	No. However, the UK has implemented a temporary permissions regime (TPR) under which EEA-authorised banks that held a passport pre-IPCD can operate in the UK under the terms of their old passport for a limited period.	Credit institutions that are authorised in one country of the European Economic Area (EEA) are generally entitled to conduct their business without authorisation by way of a branch established in Country	No

* This is a summarized interpretation of various requirements. Companies wanting to learn more should conduct their own research and engage with relevant bodies.