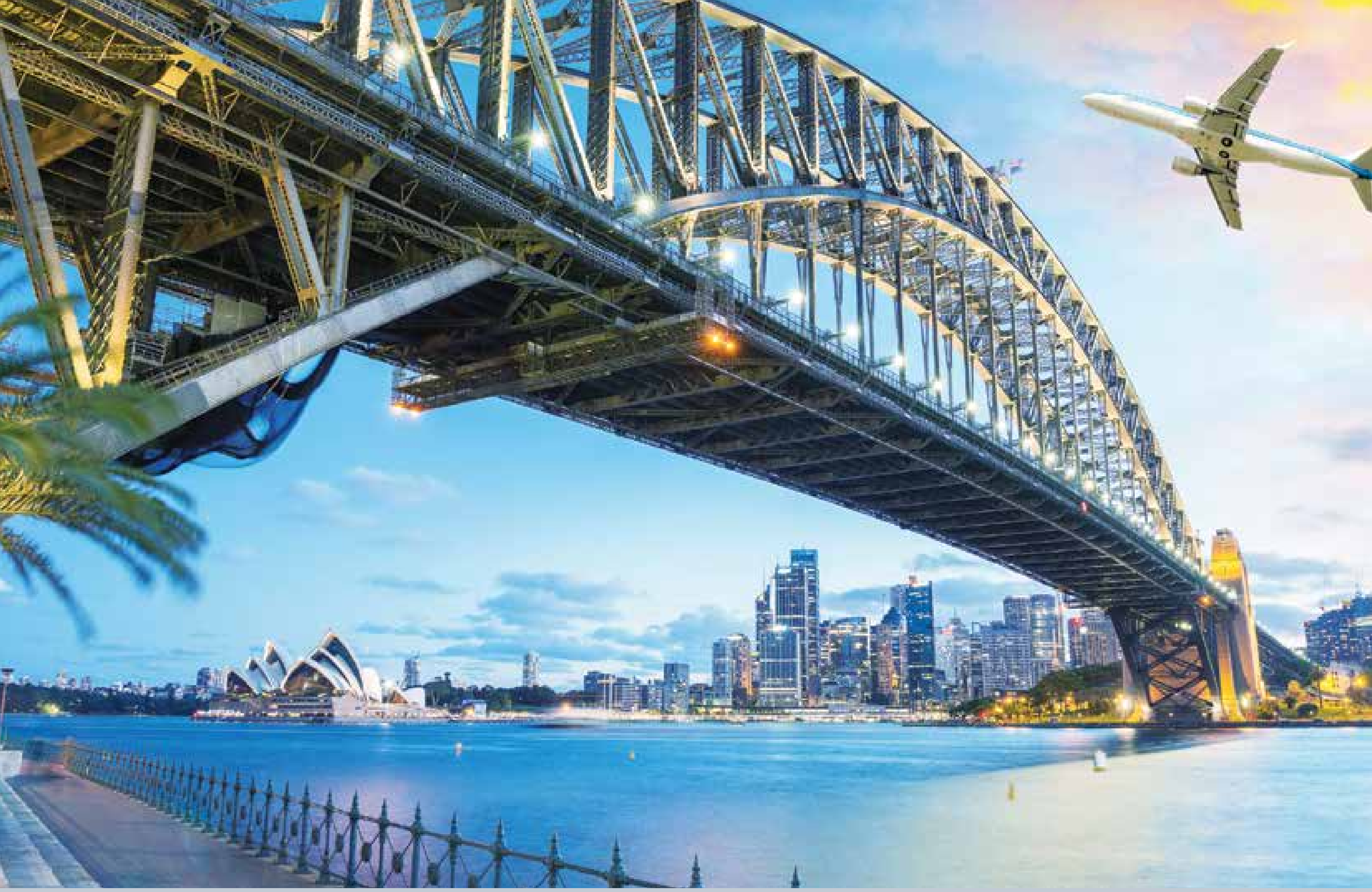

Voluntary Market Exit
Australia: Xinja Bank (2020-2021)

Background and context

Xinja Bank Limited (Xinja) was founded in 2017 as a digital or neo-bank in Australia. Xinja received a restricted Authorised Deposit-taking Institution (ADI) license from the Australian Prudential Regulation Authority (APRA) in December 2018, followed by an ADI license without restrictions from APRA (under the Banking Act 1959) in September 2019.

> ***Xinja is creating new digital banking experiences that combine data, technology and fun ... its event-driven architecture enables a 'Netflix'-like experience for customers***
>
> Xinja Bank

Xinja targeted retail consumers with product offerings that included a high interest savings account called *Stash*, deposit accounts, debit cards, payments and transfers, as well as share trading. Its leadership team comprised bankers, experience designers, technologists and former regulators, aiming to build a bank designed in the interest of customers and delivered through a 'brilliant mobile experience'.

Without legacy systems and branch networks, Xinja's value proposition was for customers to benefit from its low overhead and operating costs, in the form of competitive rates and lower fees. For instance, its *Stash* account offered an interest rate of 2.25% on balances up to AUD245,000 ($167,000) with no conditions (no minimum deposit balances, transactions or fees).[79] Xinja was reported to have received AUD200 million ($137 million) of deposit inflows within one month after launching *Stash* in mid-January 2020, and its total deposits then grew to AUD457 million ($315 million) in June 2020.

More broadly, Xinja argued that its entry facilitated banking competition and innovation in a market dominated by several large banks in Australia.

[79] In comparison, other high interest savings accounts in the market offered interest rates at just over 1% p.a. Other digital banks, Up Bank and 86400, also offered rates of 2.25% p.a. at that time, but with conditions such as minimum transactions with a linked account, smaller balance limits or minimum monthly deposits. However, by November 2020, Xinja had reduced its maximum interest-earning balance limit to $50,000.rotection applies for three months and is linked to the amount of the purchase agreement

Concerns on funding and business model

There are two broad reasons leading to Xinja's decision to leave the banking market. First, its capital raising strategy which fell through. Second, Xinja's business model proved to be unsustainable with the absence of revenue generating loan products to match costs from interest payments to depositors and operations.

In total, Xinja secured funding of about AUD100 million ($71 million). This began through equity crowdfunding campaigns in 2018 and 2019 where Xinja raised more than AUD5 million ($3.5 million). Subsequently, Xinja received additional investments from Australian and international institutional investors.

On 24 March 2020, Xinja announced a substantial deal with World Investments P.S.C. (WI), an investment company from the United Arab Emirates. Under this arrangement, WI planned to invest AUD433 million ($259 million) over the next two years in exchange for a 40% stake in Xinja. An immediate injection of AUD160 million ($96 million) was on the cards. However, it was reported that the funds were held up owing to COVID-19-related issues and this arrangement was in the form of a non-binding memorandum of understanding. In the end, the deal with WI failed to materialise and this greatly impacted Xinja's ability to sustain its business model.

As described earlier, Xinja began by offering high-interest deposit accounts (*Stash*) in January 2020. However, upon surrendering its license in December 2020, Xinja had yet to launch any loan products (home and personal loans were under development). This meant that without a revenue stream, Xinja was 'burning cash' as it absorbed continuing losses from payments of interest on deposits. Moreover, reports indicated that Xinja's operating costs were on the rise.

Over the course of 2020, interest rates on Xinja's *Stash* account was progressively lowered from 2.25% to 1.50% (several reductions were consistent with monetary policy decisions by the Reserve Bank of Australia). Despite these lower rates, Xinja's losses widened from AUD22 million ($15.4 million) in 2019 to AUD36 million ($24.8 million) by June 2020.

In addition, it was reported that concerns on the sustainability of Xinja's business model – in terms of dependency on capital raising from third parties - were flagged out by its auditors. Xinja's former auditor had resigned in April 2020.

In the end, Xinja exited the banking business in mid-December 2020, attributing the decision to the adverse impact from COVID-19 and difficulty of the capital-raising environment in seeking investors for a new bank.

Voluntary market exit

Xinja decides to return deposits to customers and surrender its banking license

> ***Xinja's decision to exit the banking industry ... is a commercial decision. As Australia's financial safety regulator, APRA will closely monitor the return of deposits to ensure all funds are returned to Xinja depositors in an orderly and timely manner. In addition to the return of deposit process, Xinja's depositors remain protected by the Financial Claims Scheme***
>
> Australian Prudential Regulation Authority

On 16 December 2020, Xinja announced its intention to return all funds to depositors and relinquish its ADI license. It had 37,884 customers with 54,357 individual deposits, collectively worth more than AUD252 million ($191 million). Customer deposits in Xinja were reported to have progressively declined from AUD$457 million ($315 million) as at end-June 2020, to AUD413 million ($290 million) as at end-October 2020, and subsequently to the lower amount as at 16 December 2020 due for reimbursement to depositors.

According to reports, Xinja provided customers with a seven-day notice prior to closure of their *Stash* savings accounts, with automatic return of any remaining funds thereafter. Additionally, Xinja's customers were advised to transfer funds out of transaction accounts which, once empty of cash balances, would be automatically closed after 29 December 2020.

By 16 January 2021, Xinja announced that it had successfully reimbursed all deposits to its customers. A point of interest was that the remaining tail of a small portion of deposits (4,176 accounts worth AUD65,809) were effected through a voluntary transfer from Xinja to new accounts or customer's existing accounts with another bank, the National Australia Bank (NAB). The specific customers were advised of the transfer and follow up actions with NAB. In that regard, NAB facilitated arrangements such as enabling fee-free accounts for customers, and continually engaged APRA. Another noteworthy point was the exercise to transfer the remaining deposits to NAB was formally approved by APRA via its powers under the Financial Sector (Transfer and Restructure) Act 1999 and Banking Act 1959.

Voluntary Market Exit of Xinja Bank - Timeline of Key Events

December 2018
Received restricted ADI license from APRA; losses of AUD6.5 million in 2018.

2018-2019
Raised AUD5 million via equity crowdfunding; obtains other investments from local and foreign institutional investors; losses of AUD22 million in 2019.

9 Sep 2019
APRA grants ADI license (without restrictions) to Xinja.

15 Jan 2020
Launches high interest savings account *(Stash)*. Deposit inflows of AUD200 million in first month.

24 Mar 2020
Announces investment from WI worth AUD433 million over two years. Deal fails to materialise in coming months due to COVID-19 related issues.

May-Jun 2020
Reduces interest rates on *Stash* account by 0.45%; as at June 2020, held deposits of AUD457 million with losses of AUD36 million.

16 Dec 2020
APRA issues statements on close monitoring of ROD, assurance of deposit protection via Financial Claims Scheme.

16 Dec 2020
Xinja announces Return Of Deposits (ROD) process and surrender of ADI license to APRA.

16, 19 Jan 2021
Xinja announces completion of ROD including remaining tail deposits; APRA issues statement on details.

26 Feb 2021
APRA announces formal revocation of Xinja's ADI license.

Aug 2021
APRA issues updated licensing approach for new banks; APRA reported to be investigating Xinja's earlier capital raising tactics.

Actions taken by APRA

APRA provided timely and relevant information flows to stakeholders via media releases on 16 December 2020, 19 January 2021 and finally on 26 February 2021 to announce the formal revocation of Xinja's ADI license. The authority noted that this was the first time a return of deposits to customers had been undertaken by an Australian ADI. APRA provided assurance of its close oversight of the return of deposits process, as well as reiterated the safety net protection for depositors under the Financial Claims Scheme (for deposits up to AUD250,000 per account holder).

In August 2020, APRA had announced a review of its ADI licensing regime, taking into account lessons since the launch of its restricted ADI licensing pathway in 2018. A consultation paper was issued in March 2021, culminating in final revised requirements in August 2021 which placed greater emphasis on the on-going viability and business sustainability of potential entrants. Among others, restricted ADIs were required to have a limited product launch (for assets and deposits), coupled with expectations for improved contingency planning towards an orderly and solvent exit from the banking business.

> ***This revised approach effectively targets key risks for new entrants, setting a higher bar for gaining a bank license, while enhancing competition by making it more likely new entrants can find their feet and gain a firm foothold in the market***
>
> John Lonsdale, Chair of the
> Australian Prudential Regulation Authority

Key takeaways

The experience of Xinja raises two key issues when it comes to the introduction and mainstreaming of digital banks into the financial sector. First is the complex policy trade-off to balance development and regulation, all while digital evolution is taking shape. Assessing the prospects and sustainability of new banking entrants in a technologically driven and fast-paced operating environment can be highly challenging. Secondly, the business models of digital banks itself – ownership and funding structures, path to scale and profitability, product value propositions for specific market segments, resilience in the face of financial and operational stress – are being differentiated and subject to changing market conditions as medium to long term projections remain uncertain.

In Xinja's case, the strategic intent to drive innovation and competition was clear and it succeeded in attracting depositors. But failure to launch any loan products left the business model exposed and dependent on future funding flows, which proved too much to bear. Similar to several other new entrants, Xinja initially operated under the terms of a restricted license granted by APRA in 2018. Here, it is important to recognise that during the same period as Xinja and within the Australian market itself, other digital banks have continued to make progress with targeted strategies such as Judo Bank's focus on SMEs,[80] and Volt Bank's adoption of the '*banking-as-a-service*' model.

> ***Nearly all jurisdictions in our sample require sponsors to develop an exit plan … this requirement is novel as a bank just starting out is not necessarily expected to fail, and this requirement is an explicit recognition by prudential authorities that tech-driven business models are unproven, particularly during an economic downturn***
>
> Financial Stability Institute

Another key lesson from Xinja's case is the value and importance of contingency and exit planning, to safeguard the interests of depositors and avoid disruptions to the broader financial system. These involve policy requirements by regulators, as early as the licensing process, for prospective digital banks to develop strategies for an orderly exit from the system (in addition to deposit insurance coverage). These forward looking plans cover, among others, elements of governance, triggers, exit options, financial resources, and communication strategies. They are crafted by the digital banks and monitored by regulators to ensure fitness for purpose upon required activation to facilitate effective market exits. As demonstrated by Xinja's return of deposits within a short period (for the first time in the Australian banking sector), the execution of such plans are vital to maintain public confidence, more so for jurisdictions that have not experienced any bank failures for a long time.

With the return of deposits, Xinja's case was perceived to be a 'successful failure'. Besides Xinja, the experience of other digital banks indicate the novelty of new business models, particularly when viewed from the lens of market exits and closures. Such actions can be voluntary or implemented as part of other business strategies. Take the case of 86 400 – another Australian digital bank licensed by APRA in July 2019 – which was fully acquired by UBank (part of NAB) in 2021, mainly for 86 400's technology platform.[81] In other parts of the world, N26 (a German digital bank) voluntarily exited the UK and US markets. Other examples include the closures of stand-alone digital banks that were established by banking groups, such as Finn by JPMorgan Chase and Bo' by the Royal Bank of Scotland. These cases demonstrate the importance of having robust exit policies as part of continued regulatory oversight of new digital banks.

This dovetails into another lesson to be drawn from Xinja's case. Financial sector authorities play a crucial role, even in the situation of a voluntary market exit by digital banks. APRA was clear in its public communications and provided details at key stages of Xinja's process of returning deposits to customers. The authority also stepped in to facilitate the transfer of remaining tail deposits from Xinja to NAB, thus bringing closure to the exercise. In parallel with Xinja's announcement of its market exit and return of customer funds, APRA emphasised the protection of deposits via its Financial Claims Scheme. This was important to provide depositors with assurance during times of uncertainty.

Relatedly, prior to Xinja's exit announcement, reports indicated that its deposit holdings were already on the downtrend. This observation highlights the need for market players and regulators to better understand any distinctive risk behaviours of depositors in digital banks.

A final point is the imperative of close interagency coordination for jurisdictions with different authorities responsible for various aspects of overseeing digital banks, such as roles in licensing, regulation and supervision, as well as deposit insurance and resolution. Additionally, the prominence of technological and other emerging risks from new business models of these entities call for greater agility and differentiation from previous regulatory approaches taken by the authorities.

[80] Judo received its ADI license in April 2019. As at June 2021, its loan book stood at AUD3.5 billion with deposits of AUD2.5 billion. In September 2021, Judo was awarded an investment-grade credit rating (BBB-) by S&P

[81] 86 400 was acquired by NAB for AUD220 million ($169 million). As at 15 January 2021, 86 400 had more than 85,000 customers, AUD375 million ($288 million) of deposits, AUD270 million ($2017 million) in approved residential mortgages and 2,500 accredited brokers