THE DANGERS OF POLICY FOCUS ON DIGITAL TRANSFORMATION

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Abstract: *Whilst it is easy and comforting to accept that policymakers widely embrace digital transformation, it is rather important that scrutineers remember the recent near-misses. Consumer Banking, Smartphones, FinTech all provide a host of examples of near-misses, none of which were stopped and or blocked by Regulators.*

The goal of this paper is to draw readers' attention to a few experiences which the author has experienced, both in London and Sofia, and to encourage a substantial slow-down of the overall initiative.

Keywords: *Digital transformation, FinTech, Consumer Banking, UK Neobanks, EU Neobanks,*

1. Executive Summary

Whilst it has become very fashionable for western governments to champion digital transformation (DT), a number of flawed assumptions, together with the law of unintended consequences, dictate that now is the time to pause, reflect and assess if it is beneficial for societies to continue along the DT path. The author, for one, feels that we have gone too far. With DT comes the insertion of AI, chatbots, and automated response and increasing difficulty for citizens to gain the attention of a customer service human being. In the private sector this is bad enough, as banks and other companies adopt DT at least they have the incentive to maintain customer relationships and earn profits. In the public sector there are no such incentives with the obvious result of a reduction of quality, immensely long waiting times for responses, and no downside to the public sector whose monopolistic control of citizens is hardwired.

For reasons of brevity the author now sets out certain areas where DT has gone so far that customers are frankly scared of raising issues for fear that they will not only gain no resolution, but that their security and funds may in fact be compromised merely by raising concerns.

2. Consumer Banking

Having held a bank account with Lloyds since arriving at boarding school in 1976, your author has experienced every iteration of bank customer service in the intervening 48 years. My first employment on graduating was in fact with Lloyds on their management training programme. In all my trainings it was drummed into me that of paramount importance is the maintenance of the customer relationship, of not losing the customer to eg Barclays Bank.

Sadly, for the vast majority of customers, banks appear to be no longer concerned on this point. Two reasons: firstly, the never ending promulgation of costly regulations means that the ‘base profit’ threshold which banks need to earn in order for specific customer relationships to be profitable as opposed to loss making has risen sharply. Secondly, the continuing banking crisis which incepted 2007-09 and has never been properly addressed, has resulted in the permanent abolition of the interbank market. For clarity, despite all the weaknesses of the fractional reserve banking model, prior to the Great Crash it was at least functioning ostensibly normally in that at the end of each business day after payments made and received by customers of Lloyds resulted in a net cash surplus or deficit, traders in the money markets department of Bank A would notify “the interbank market” that it had an overnight cash surplus or deficit. The interbank market operated to clear these differences among the banks. Crucially the interbank market operated WITHOUT collateral, because each bank was assumed to be of undoubted credit solvency.

Such assumptions disappeared when governments, in your author’s view foolishly, chose to burden citizens by borrowing money and basically donating it to failed banks who were thus propped up like dinosaurs. Further direct consequences of these regrettable bailouts were that all western central banks set interest rates at or near zero levels to reduce the visible cost of national borrowings. This interest rate policy, together with the erosion of trust and confidence between banks as evidenced by the detah of unsecured, uncollateralized interbank markets, resulted in commercial banks earning trivial to zero returns of customer deposits which they continued to hold in cash. The only safe course of action was to deposit these funds with eth central bank who for many years between 2007 and now were offering negative returns on such deposits. Many banks, not only in Euroipe but also in USA openly advertised that they had no appetite for new customer business and frankly were all to happy to shut down often long standing customer accounts should the individual dare to raise his/ her head above the parapet by, for example, questiong whether rainbow flag redecorations of bank branches during LGBTQ+ month were a sensible use of bank funds.

3) Smartphones, calendars, autoresponses and spam messages

Your author is staggered by the lack of questioning as to whether the ubiquitous appearance of smartphones, since the demise of Blackberry around 2010-12, is beneficial. Once again it appears that DT progress is assumed to be beneficial, whereas in reality this assumption is highly open to question. A few examples.

a) Digital calendars. Your author has a 2022 Apple SE smartphone, with tons of RAM and lots of attractive features. However, the embedded MS Outlook email system has at its core a calendar function which it is now impossible for me not to use. But the operation of this calendar is far from perfect. One of your author's projects involves weekly Googlemeet calls with my small group of teammates.

   These have been occurring throughout calendar 2024. However, about three months ago the date was switched from Wednesday each week to Thursday. Since the switch, every Wednesday morning my phone pings with a Calendar Message. When I open the message I see my day's schedule; if I have put no other engagements in my calendar I simply see the Wednesday meeting with lines through the entry indicating that it is cancelled. I do not want to receive these pointless pings but have no idea how to delete and cancel them.

b) Autoresponses. Every day I receive about 30 or 40 spam emails from publications or websites which I once logged into, and was obliged to enter my email address in order to read the odd article. Alright, as regards this point I do in fact know how to cancel the messages for the future, but receiving them is highly irritating and would never have occurred in the pre-smart phone era when the sender would have had to pay two or three euros for postage. Free communications mean spam communications.

c) Choice of communication protocol. Owing to time constraints I have not checked this point with colleagues in Bulgaria or other EU member states, but it is absurd that if I want to contact my bank I am forced to use the telephone. Always there are long waiting times, typically ten to twenty minutes waiting to speak to a human. Then a time consuming identification process. Invariably the bank employee wants to transfer me to another department – the process changes all the time. When he/she does so, the painfully slow identification process I have just undergone is invalidated and starts again.

   If I am lucky, only one transfer will be required but often two or three are necessary. For the aove reasons it can easily take one hour on the phone to clarify a relatively simple question. It is immensely frustrating that some banks use text messages or even emails to reach me, but they NEVER agree to receive messages on these platforms.

The bank business model is crystal clear. My time is of no value to them so they see no problem in consuming yonks of my time whilst they invest the minimum of their time.

d) Spam messages. Criminals are becoming increasingly sophisticated and the only safe assumption is that every email and text message we send is being read and studied by criminals. Fraud is increasing exponentially in the UK and many individuals fail to take relatively obvious steps to prevent losing substantial sums of money. I recently (2017) took out a mortgage on a second home in order to help a family member. The lender provided the legal service for free, but it was an "e- legal " service meaning ath I had no personal relationship with anyone who worked in the (Indian) legal team. All the emails had a certain format. It is standard practice for criminals to duplicate this format and send a spoof email demanding the 10% deposit payment one month before title to the property is transferred. Rather than call the lender and check the details many UK citizens simply make the payment, often of GBP 40,000 or more to the account of an Albanian criminal.

   The bank usually forces the customer to absorb this loss arguing, correctly, that the customer should have checked the genuineness of the email and the stated bank account details. This position is wring; and also counter to money laundering rules that require banks to carry out identity and fraud checks before opening accounts. But this observation is of scant consolation to the defrauded individual(s).

4) **Fintech – Revolut, Likely Insolvent**

a) Consumer Facing Fintechs; Struggling for Profits and Remaining Private

Two years ago your author wrote about Germany's most prominent neobank, N26. It had then recently withdrawn from both the US and the UK for regulatory reasons but was valued at USD 9bn based on its then latest capital raise, despite reporting 2020 losses of EUR 151mm. Its losses have since nudged upwards, EUR 172 mm and 213 mm in 2021 and 22 respectively. It also had problems with its regulator because of lapses in anti-money laundering controls; BAFIN fined it EUR 4.5mm in 2021 and subjected it to a severe cap on customer onboarding that was only slightly relaxed last December. In 2023 it laid off 4% of its staff and announced a pivot into stock trading and selling ETFs. One wonders today if any path to profitability is possible.

Two years ago I also reviewed two loss making British neobanks[1], Monzo and Revolut[2], both of whom continue to struggle, if we treat BDO's (the auditor's) qualification of Revolut's 2021 accounts: *"unable to satisfy [BDO] as to the completeness or occurrence of revenue totalling £478 million"* as eliminating the claimed trivial surplus.

I recognise that well managed neobanks can be successful. I have previously praised Wise and now compare the two with Starling Bank, formed in 2014, which has made profits for two years. Monzo has a higher profile but is still lossmaking. Let's compare some financial KPIs:

Table 1

	Customers (GBP mm)	Gross Revenue (mm)	Profits (losses) (mm)	Staff number and y.o.y growth
Starling March 2023	3.6	453	195	2700 (+39%)
Monzo Feb 2023	7.5	355	(116)	2547 (+13%)
Revolut December 2022	26	923	(25)	6000 (+100%)

It is entirely reasonable for start ups to focus on gross revenue rather than net profits when in their infancies. But Monzo and Revolut are almost ten years old, with fairly large customer bases (Monzo is the 7th largest UK bank by customers) and questions must arise as to the viability of their business models. Monzo aims to achieve profitability by expanding both into the US and Europe at the same time. In the US it remains unable to obtain a banking licence and will partner with a US bank which will be a drag on earnings. Europe opens up exposure to new cultures, languages and rules, and has proved tough for US and UK banks before. Monzo may of course succeed, but the path to profitability does not look easy.

If Monzo's path to profits seems uphill, Revolut's seems steeper. Revolut's numbers and press announcements appear to typify why investors remain cool on Fintech. Revolut's staff numbers

[1] Defined as app based (mainly mobile) branchless banks, often with full banking licenses eg Starling and Monzo

[2] Revolut is a "Neobank" technically speaking only in Europe where it has a banking licence; in the UK it is only an "e-money institution".

grew from 6,000 Q4 2022 to 10,000 presently, and are set to grow to 11,500 by year end[3]. It appears to be spending all its free cashflow on new employees and advertising in a dash for growth, and has been unable to raise capital since 2021[4]. Yet, as the following table shows, its revenue per customer is low and its private valuation looks dizzy:

Table 2

	Revenue per customer (GBP)	Balance Sheet Shareholder Equity (GBP bn)	Latest private valuation (GBP bn)
Starling	203	0.7	2.7 (July 2023)
Monzo	112	0.5	4.1 (May 2024[5])
Revolut	35	1	24* (October 2021)

*Perhaps unsurprisingly, investors such as Molten and Schroders have marked their Revolut holdings down by about 50% to GBP 12 bn in the past year.

b) Likely Regulatory Response – Are Regulators Paying Attention to Neobank Financial Viability Warning Signs?

For the above reasons we would expect regulators to be paying a little more attention to the risks of consumer facing fintech. Recent history shows that time and again regulators have missed warning signs, perhaps because they don't want to see them. The US missed multiple warnings prior to the 2008 collapse of Madoff's high net worth fund, and Germany's Bafin was obviously embarrassed over Wirecard in 2020. Revolut's numbers, as tabulated above, surely raise amber flags. Also it has been consistently late with regulatory filings, and its most recent two years of accounts (2021 and 2022) are were only audited with significant qualifications.

5) Public, not Private Sector

Much of the above has addressed difficulties which consumers experience with private sector companies. Most consumers just about manage to cope, although the incidence of fraud and

[3] Revolut to boost staff by 40 per cent this year amid rapid expansion (cityam.com)

[4] Revolut - Funding, Financials, Valuation & Investors (crunchbase.com)

[5] Monzo valued at £4.1bn after £150m funding to support expansion and new products (msn.com)

monetary loss suffered by elder generations is increasing rapidly and I was compelled to take my late mother "offline" in the last couple of years in her life owing to the frequency with which she was being tricked out of small but annoying sums of money – typically 50 or 100 gbp a couple of time per month.

Nonetheless, the problems increase exponentially when dealing with the local or national government. So successful have local governments become in the UK at establishing barriers such that their taxpaying citizens are forced to deal with AI and chatbots, that it is now serious government policy to reduce staff hours to a 4 day week but on the same pay, in effect a 25% pay increase for reduced productivity.

The crucial difference between the public and private sectors in this contect is that few public servants have any interest in saving public funds; their own organisation and their personal terms of employment are of far greater importance. Under the heading "Woke Waste" journalist Charlotte C Gill recently listed the following examples of extraordinary waste of UK public funds:

- GBP 841,830 in financing research into "The Europe Gay Porn Built 1945-2000
- GBP 136,909 "Perverse Collections, Building Europe's Queer and Trans Archives"
- GBP 805,769 "Decolonising the Museum: Digital Repatriation of the Gaidinliu Collection from the UK to India"
- GBP 185,627 "Trans Performance Now: Glitching cisgenderism"
- GBP 805,745 "Diverse alarums: centering marginalised communities in the contemporary performance of early modern plays"
- GBP 205,543 "Decolonial Ecologies in the 21st century insular Hispanic Caribbean film"
- GBP 759,293 "Comics and Race in Latin America"
- GBP 81,635 "Listening to the 85%: exploring how recording and listening to underwater sounds can increase environmental awareness on the Isle of Man"
- GBP 123,470 "Decolonizing South East Asian sound narratives"
- GBP 783,083 "Everything is Connected: Conspiracy Theories in the Age of the Internet"
- GBP 200,462: "Decolonizing the Page: The Visual Politics and Poetics of Postcolonial Arabic Publications".

For brevity your author ends the list here, but there are many, many more. Two points leap out from Mr Gill's work[6]. Firstly, many of these grants of UK taxpayer funds are applied for and awarded to foreign students studying at foreign universities or institutions; thee is no requirement for any of the funds to be spent in the UK. Secondly, using the word "decolonizing" in the application seems to be a surefire way to fast track the application for funds.

[6] @CharlotteCGill account on X, 30/10/2024

Of course this is meerly one study of UK wastefulness. Others have produced similar lists for the US. And of course the large elephant in the room is Net Zero. It was recently announced that the United Nations has “lost” USD 41 billion of Net Zero funds. This is a staggering sum, but few readers were surprised.

6) **Conclusion**

There is a popular and true saying, “*Never trust a public servant with a computer and bulk data*”. There are multiple examples of public servants leaving laptops or data sticks on trains, in buses and taxis. A senior UK tax official admitted losing a data stick with the personal details of almost every UK taxpayer on a data stick. The adult hookup site for married people wishing to cheat: “Ashley Madison” was effectively bankrupted and needed recapitalisation in 2015 when hackers stole, and subsequently published, all of its customer data including names, addresses, sexual fantasies and credit card details.

One rarely mentioned consequence of the now decades long trend of digital transformation is the increasing length of documents. As a junior officer at Bank of America International in 1985 I was involved in syndicating one of the then largest loans in the world; USD 14 billion for SOCAL (Standard Oil of California). The termsheet which I codrafted was 4 pages long. Hardly any capital markets transactions are launched these days with termsheets of under 50 pages. Almost every day the ECB publishes a new paper on some aspect or other of monetary policy or bank supervision. Few of these papares are less than 100 pages long. It is common knowledge that few policymakers or academics typically read more than the Executive Summary and Conclusion. Few individuals can work all day and devour a number of 100 page papers at night.

My 4 page 1985 termsheet is shorter than the disclosures section in modern capital markets termsheets. Looking back, we did not use disclosures; the concept was not invented until the 1990s.