GUIDE

# Partnering with Financial Institutions: What Fintechs Can Do to Prepare

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INTRODUCTION

# Bank-fintech partnerships will shape the future of financial services

The long-standing tradition of holding fintechs at arms' length is disappearing, and banks and credit unions are more receptive than ever to the innovative solutions offered by financial technology companies. Whether it's streamlining existing processes or delivering new services, financial institutions are looking for ways to be more competitive and more efficient. Fintech partnerships enable this much-needed digital transformation and can help banks gain access to new customer segments, new business models, and new revenue opportunities.

But how can innovative and entrepreneurial fintechs partner with financial institutions that are highly regulated and risk averse? What risks do banks and credit unions face that financial technology providers need to understand before they can support them on their journey to digital transformation? What questions can a fintech expect from institution executives and boards as they explore new partnerships? And what policies should fintech businesses have in place to ensure their bank relationships are successful?

**This e-book will explore the maturing financial landscape and how fintechs can make the most of this evolution, including:**

- **What financial institutions want in a fintech partner**
- **How financial technology organizations can make themselves an attractive partner to banks**
- **Pitfalls to avoid in a fintech/bank partnership**
- **A checklist to help financial technology businesses prepare to partner with banks and credit unions**

**If your fintech company wants to partner with financial institutions, we'll show you the steps to take to ensure you have the right groundwork in place for effective partnerships that support banks' digital transformation strategies, while managing compliance and risk.**

# Fintechs see massive growth in financial institution partnership opportunities

## Consumers want speed and convenience

Customer demand for integrated experiences is just one of the trends McKinsey sees driving the banking-as-a-service and embedded-finance arenas. For consumers, fintech solutions enable faster and easier access to funds, and more convenient access to financial services and products. The buy now pay later (BNPL) landscape is an example of the popularity of fintech offerings. A recent survey from PYMNTS.com and Amount revealed that **70%** of consumers already using BNPL expressed interested in using BNPL plans from their banks if such offerings were available, and **47%** of those with annual earnings above $100,000 said they want a BNPL plan from their financial institutions.

## Banks and credit unions want to expand their revenue potential

A recent McKinsey analysis of leading financial institutions shows that **55%-70%** of their revenues come from origination and distribution, compared with **40%-50%** for an average bank. In addition, industry leaders leverage digital channels to interact with customers **two to three times as frequently** as the average bank. As financial institutions consider fintech offerings in response to consumer pressures, they're rethinking how technology may help them drive revenue and pursue more innovative business models.

## Regulators respond with positive advice

Regulatory agencies acknowledge the value of fintech-bank partnerships. The Federal Reserve's Consumer Compliance Outlook points to the efficiency and effectiveness gains community banks can achieve through the use of financial technology. Further highlighting the expanding collaboration between financial institutions and fintechs—and the critical nature of the services many of today's vendors deliver—the Federal Reserve, the Federal Deposit Insurance Corporate (FDIC), and the Office of the Comptroller of the Currency (OCC) came together to release a guide that gives banks important advice on managing these third-party relationships.

## More market opportunities for fintechs means more competition

Financial institutions are tuned in to the signals coming from consumers and regulators alike.

> A study from Cornerstone Research found that almost **two-thirds** of banks and credit unions entered into at least one fintech partnership over the past three years.

Of those that haven't yet partnered with or invested in a financial technology firm, **37%** plan to partner in 2022.

But as the opportunities increase for fintechs, so does the competition. Fintech accounted for **20%** of global venture funding in 2021. The year was a new high in financial technology venture capital investment, surpassing the previous record set in 2018. And as more players enter the field, high-performing fintech companies need a way to stand out from the crowd as trusted industry partners.

# What do banks and credit unions want in a fintech partner?

Before trying to unpack what a financial institution might be looking for in—and from—a fintech partner, it's first necessary to understand the wide range of ***risks financial institutions face*** as they explore the possibility of working with financial technology firms.

- Introduction of potential compliance violations
- Unknown level of vulnerability to cybersecurity threats and/or data privacy breaches
- Continued (or even increased) operational friction and inefficiencies
- Dysfunctional systems or a poorly integrated technology stack
- Low user adoption or a poor customer experience

Many banks and credit unions have limited resources to help them along their digital transformation journey. Staffing is lean, some lack key in-house technology expertise, and funding is finite. Trying to address these risks internally often seems overwhelming. Institutions want a fintech partner that can not only solve for their business use cases, but can also help them identify, evaluate, and mitigate risk areas that may emerge along their digital transformation journey.

With the risks in mind, you can better understand ***what financial institutions want from a fintech partnership.***

$11.5 million UDAAP enforcement action highlights banks' risks in developing fintech partnerships

**Incident summary:** A loan originator/servicer partnered with merchants to offer financing to customers using a network of partner banks. The loans were disbursed directly to merchants. Consumer complaints show that some people hadn't applied for or authorized a loan, or even heard of the loan originator.

**Number of complaints received:**
at least 6,000

**Violation timeline:**
between 2014 and 2019

**Illegal loans refunded/cancelled:**
up to $9 million

**Civil penalty:** $2.5 million

## A partner that actively contributes to a strong compliance posture

The guide released by regulators and other agency actions related to fintech partnerships all place a heavy emphasis on due diligence, ongoing compliance, and vendor management best practices. Financial institutions are ultimately responsible for the actions of their third-party vendors, and the introduction of a financial technology provider into the mix has the potential to reshape their compliance risk profile. Banks and credit unions are keen to work with fintechs that can demonstrate they maintain solid compliance practices and controls, especially where vendor management is concerned, and can facilitate ongoing adherence to an ever-evolving array of regulatory mandates.

## A partner that knows how its technology aligns with banks' needs

If your fintech can't demonstrate the value of your platform beyond the cool factor—or in relation to a specific need the bank has articulated—then don't be surprised if they call a stop to the discussion. Banks and credit unions want a fintech partner that can help them solve for key strategic and operational needs, not just create another level of complexity within their technology stack. Most financial institutions expect to see data and metrics as proof points that your solution will help them accomplish their objectives.

## A partner that helps drive user adoption and/or customer satisfaction

Banks and credit unions know that end users need to be confident in their ability to effectively incorporate new technologies into their workflows, otherwise there's a high risk that people will fall back on old processes, that users could introduce errors into the new processes, or that the financial institution may fall out of compliance. They're also aware that if a new technology launch falls flat with customers, then the return on their technology investment will be low and customer satisfaction might drop. Financial institutions expect their fintech partners to support training efforts and customer rollout programs to ensure success.

# How to make your fintech an attractive partner for banks and credit unions

First, **be ready for a rigorous (and continuous) vendor management program.** Financial institutions know they're ultimately responsible for the actions of their third-party providers and they expect their fintech partners to not only participate in the vendor management process but to also anticipate their due diligence and related needs. You can smooth out the process by assigning tasks such as document preparation to in-house team members and assembling experts to quickly respond to questions from prospective clients.

You should **know your organization's legal and regulatory compliance profile** and **assemble information to show potential bank partners how you manage these risk areas.** If you don't already have them, add contract provisions to ensure your business is compliant with all applicable laws, regulations, and ethical standards. Explicitly spell out your data privacy and data residency details if applicable. A failure on your part to properly process, store, manage, or use either the financial institution's data or consumers' personal information could result in litigation against you and a compliance nightmare for your institution partner.

You should also ***maintain flexibility during the contract negotiation process*** to incorporate language into your contract that aligns with your potential partner's internal policies and procedures, particularly if you will deliver consumer-facing products or services. Controls should be clearly defined in the contract to enable the financial organization to oversee the relationship and confirm ongoing compliance with its terms and expectations.

You'll want to **develop a comprehensive business continuity plan (BCP)** and **offer it to prospective customers as part of the due diligence process.** The past few years have driven home the concept that a BCP is not a nice-to-have—it's an imperative. Banks and credit unions proved themselves to be agile and adaptable during the pandemic, and forward-looking financial institutions know it's important to partner with a fintech that shares their resilience. Include an enterprise-wide business impact analysis (BIA), communication plan, and an outline of your anticipated recovery process.

A preferred partner will **develop a third-party risk management strategy** and **have it available for review.** You need to show that you can identify, mitigate, and manage risk across your enterprise's third-party vendor list. From eliminating cyber vulnerabilities to plugging gaps in compliance monitoring, fixing uneven data privacy practices, and building depth in your BCP, your bank partners want to know you've properly assessed your environment both upstream and downstream. They expect their fintech partners will maintain compliance across the entire operation, even in the face of business interruptions or changes in the vendor market.

Pull together the right expertise to **educate prospective financial institution clients on your organization's internal controls.**

- How do they work?
- Who's involved in developing, reviewing, and updating them?
- What happens if your system flags a problem or risk?
- What are the next steps and how is the financial institution alerted to potential issues?

Banks and credit unions expect their fintech partners will have risk management controls in place, that those controls will be diligently monitored, and that the technology provider will take timely action on any findings. If your team can demonstrate that you've already thought through compliance—including advanced actions such as completion of a Statement on Standards for Attestation Engagements (SSAE) 18 audit—and risk management, and then crafted a strategy to swiftly identify and mitigate problems, it will give the financial institution confidence they can count on you as a trusted partner.

> The high regulatory oversight that exists when fintechs and financial institutions partner up calls for additional attention to ensure that everything evolves as planned.

# Pitfalls to avoid

Any business relationship has the potential to introduce risk. To get the relationship off on the right foot and keep it humming along, financial technology providers should understand where pitfalls exist and take proactive steps to avoid them.

**Failure to disclose critical subcontractor dependencies.** In the event of a business interruption, your bank and credit union partners expect you to take responsibility for your third-party providers. If you haven't assessed the resilience of your vendor management program and one of your subcontractors either causes the disruption or can't swiftly remediate or mitigate the disruption, all fingers will point to you. This may even violate the contract with your financial institution partner if the causing vendor wasn't properly disclosed, leaving you at risk of litigation and severe reputational damage.

**Lack of understanding about the bank's technology stack.** Financial institutions frequently have legacy solutions lurking within their environment that have limited or nonexistent integration capabilities. In addition, your fintech can't assume that everything the bank or credit union has told you about their existing systems is accurate and complete, since IT staff may not have the right technology expertise to conduct an effective assessment of capabilities. Without clear and detailed discussions to ensure your platform will function as expected, the implementation could be an expensive (and very public) failure.

**Lack of clarity on what the bank or credit union wants to achieve.** Over-eager or misguided executives and BoDs sometimes direct IT groups to develop fintech partnerships simply because the concept seems trendy. Or they might see competitors doing it, so why not? In other cases, IT agrees that fintechs are useful partners to enable new technology capabilities, but they don't yet have clear alignment on how the tech can serve the bank's strategic goals or whether the solution is even compatible with their current systems. If you don't know what the objectives are for the partnership, you're likely to end up with a lot of wasted time and a very unhappy client.

## READY TO START?

# This checklist will help prepare your organization for bank partnerships.

- ☑ **Review the due diligence guide released by the Federal Reserve, FDIC, and OCC.** It will help your team ensure you've covered the compliance concerns your financial institution partners are most likely to focus on and better anticipate the questions your prospective financial institution clients might ask. The guide was written with community banks' environments and needs in mind, but the fundamentals apply to financial institutions of all sizes and levels of maturity.
- ☑ **Put systems in place for compliance management.** Unlike financial institutions, fintechs aren't required by law to adopt a compliance management system—but that doesn't mean you don't need a compliance management system (CMS). Make sure you have a system to develop and manage policies, procedures, and processes to ensure that you can implement new laws, remain compliant with existing laws, and correct problems that arise. A CMS not only helps you navigate the compliance lifecycle, it shows potential partners that your company is committed to a culture of compliance.
- ☑ **Identify, measure, monitor, and mitigate your third-party vendor risk.** Fintechs rely on critical third-party vendors. If one of these vendors fails, it can create huge disruptions for both the fintech and its financial institution partners. That's why the regulatory agencies require a financial institution's vendor due diligence to considered fourth-party risk, or the risk a vendor's vendors poses. Your partner will need to know which critical activities are outsourced and what controls and monitoring your company has in place to ensure fourth-party vendors are resilient, compliant, and keeping data safe. Establishing solid, transparent vendor management processes will demonstrate your feasibility as a financial institution partner.
- ☑ **Create contracts that can withstand a rigorous review.** Bank and credit union partners want to see terms and conditions that are clear and easy to understand. Spell out your protocols for managing data privacy, customer complaints, data residency, your ethics program, etc. The more you make clients hunt through your contract language or force them to request additional information that should have been included, the less likely they are to select you as a partner.

☑ **Develop a comprehensive BCP and make it available to prospective bank clients.** This should include not only your operational considerations for maintaining business continuity, but also other important elements such as:

- The details of your BIA
- Contact (both phone and e-mail) information for your assigned team members in the event of a business interruption
- A list of critical third-party providers within your delivery chain

☑ **Prepare educational materials to support a successful partnership.** When the end users—whether they're internal employees or customers/members—know how to use the features your fintech provides, the partnership delivers maximum benefits to the bank or credit union. Create educational documentation, training materials, and other assets to help drive adoption and improve user/customer satisfaction.

☑ **Understand your bank or credit union partner's overall strategic plan.** By knowing what the financial institution is looking for—efficiency, speed, simplicity, innovation, etc.—you can tailor your services and support, as well prepare to address questions or concerns that may crop up. You'll also be better positioned to speak to compliance issues your bank or credit union partner may have and proactively deliver the right data and background to build their confidence in your organization's compliance chops.

# Conclusion

Opportunities for fintechs to partner with bank and credit unions are growing, and savvy providers stand to gain significant market early. The right technology can help you maintain regulatory compliance, manage your third-party vendor relationships, assess and automate your cybersecurity risk program, and develop your business continuity strategy. Ncontracts has the experience and expertise to help you ensure your fintech is prepared to partner with financial institutions for a safe, sound, and successful future.

*To learn more about how we help fintechs prepare to partner with financial institutions, view our website.*