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June 2023

The FinTech-Bank Relationship Shifts Toward Collaboration

FinTech Tracker® Series

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MAY 2023

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What's Inside

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Acknowledgment

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Need to Know

Bank-FinTech Partnerships Are on the Rise

Recent changes in the financial industry have begun to transform the relationship between traditional banks and FinTechs. In the past, banks have largely viewed FinTechs as serious competitors, if not existential adversaries, due to the upstarts' technological innovations, superior customer experiences and agile operations.

Nevertheless, as both sides adjust to changing customer preferences, economic pressures and regulatory challenges, the dynamic has been swinging toward cooperation. Banks' interest in acquiring FinTechs is on the rise, for example, with 15% of banks in a 2022 study saying they are investigating such acquisitions as a way to bolster their digital capabilities — up from 5% the year before. Major financial institutions (FIs) have made moves to acquire FinTechs, including JPMorgan Chase's deal with Renovite and American Express' acquisition of Nipendo.

Partnerships are also increasingly popular. According to a 2022 report citing a survey from Q3 2021, 65% of banks and credit unions (CUs) had entered into at least one FinTech partnership in the past three years. Moreover, the share of banks viewing bank-FinTech partnerships as at least somewhat important rose to 89%, compared to only 49% in 2019.

In a rapidly evolving financial industry, banks and FinTechs are increasingly viewing each other as partners.

Share of banks in 2021 that saw partnerships with FinTechs as at least somewhat important

Share of banks and CUs in 2021 that had partnered with a FinTech in the past three years

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Need to Know

The digital shift is placing pressure on banks to partner with FinTechs.

Banks can benefit from partnering with FinTechs in a number of ways. Owing to their legacy systems and complex infrastructure, banks often struggle to match the agility and speed of FinTechs when it comes to developing and deploying new solutions. Because these solutions are now a must — with more than 70% of Gen Z and millennial consumers saying they would switch banks for better digital capabilities — traditional banks are under pressure to deliver.

Indeed, a 2022 survey found that although 74% of banks viewed FinTechs as a threat, 77% of banks felt pressure to partner with one, and 76% believe doing so is necessary to meet shifting customer preferences. Through collaboration, banks can tap into FinTechs' innovation, gain access to new markets and deliver value-added services to their customers. This can drive revenue and help banks deploy solutions at a faster pace.

Banks are under pressure to partner with FinTechs to keep up with an increasingly digital industry.

77%

Share of banks that report feeling pressure to partner with FinTechs

76%

Share of banks that view FinTech partnerships as necessary to meeting customer expectations

95%

Share of banks that use partnerships to enhance their digital product offerings

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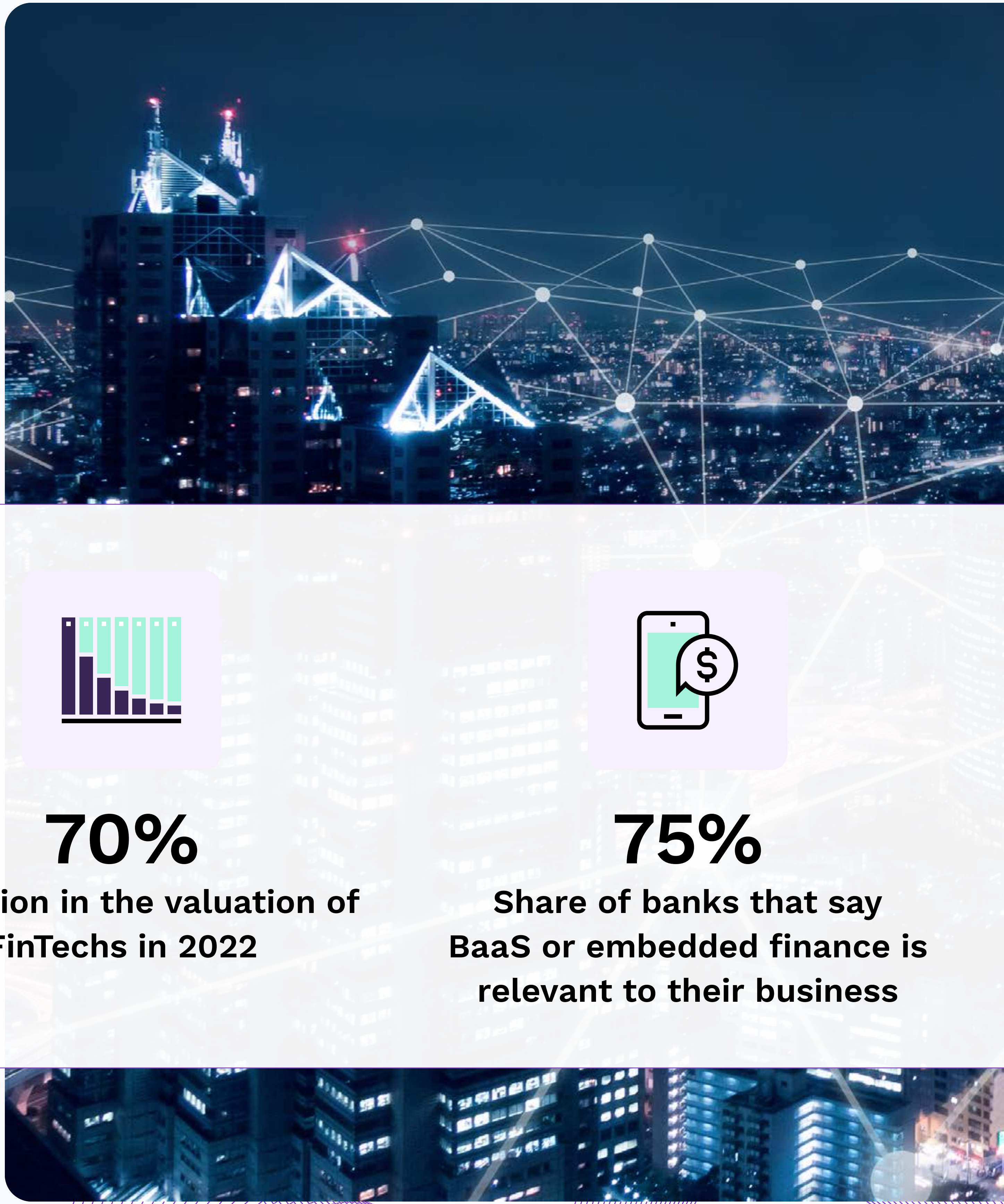
Need to Know

FinTechs can benefit from closer ties to banks.

From FinTechs' perspective, partnerships with — or acquisitions by— banks have a variety of benefits, too. Gone are the days when FinTechs had access to seemingly unlimited funding. Instead, as PYMNTS has noted, a lack of profitability has caused FinTech valuations to plummet — by 70% in 2022 — and venture capital funding to evaporate. Working with banks can provide a much-needed infusion of cash.

Partnerships with banks can also help FinTechs navigate the financial industry's complex regulatory landscape more effectively. This factor is important as FinTechs look to expand their role in banking as a service (BaaS) and embedded finance, areas that 75% of these entities say are relevant to their business. A closer relationship with banks can also enhance trust and credibility among consumers when they perceive FinTechs to have the backing of an established FI. After years of competition, banks and FinTechs are finding that collaboration can be mutually beneficial.



70%

Reduction in the valuation of FinTechs in 2022

75%

Share of banks that say BaaS or embedded finance is relevant to their business

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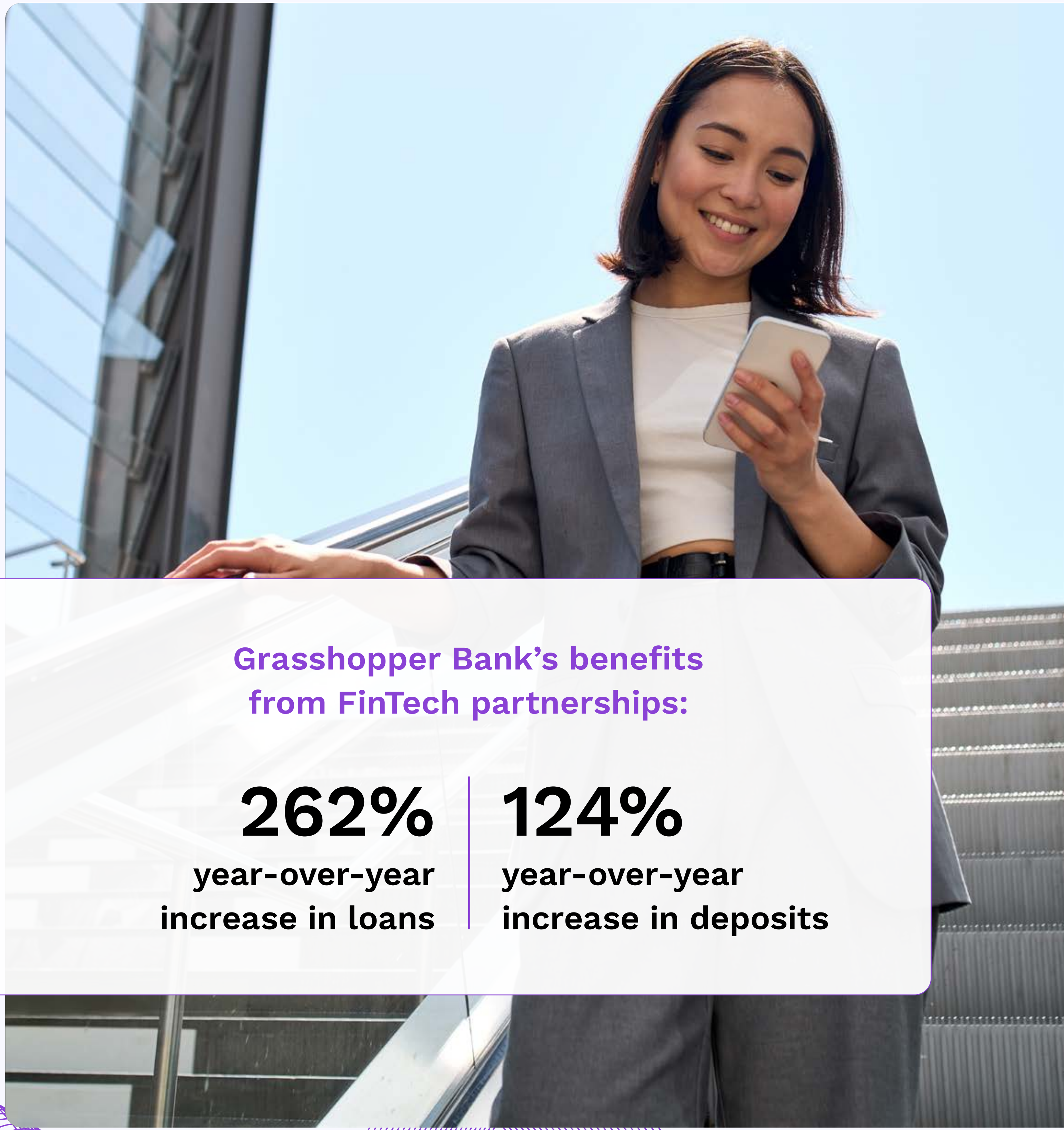
News and Trends

Bank-FinTech Collaboration Deepens Around the World

New York City-based Grasshopper Bank has been using FinTech partnerships to rebuild its technology since a 2021 change in leadership. During 2022, the bank penned deals with Treasury Prime, FIS, Visa, Autobooks and more, with the aim of modernizing and expanding its existing capabilities. Grasshopper became the first FI to use FIS' embedded finance solutions. These efforts appear to be successful so far, with Grasshopper reporting a 262% year-over-year increase in loans and a 124% increase in deposits.



Grasshopper Bank's benefits from FinTech partnerships:

262% year-over-year increase in loans

124% year-over-year increase in deposits

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News and Trends

Orange Bank announces expansion of Mambu partnership to France

Orange Bank recently announced it was migrating its head office in France to Mambu's cloud banking platform, building off Orange's partnership with Mambu in Spain in 2019. The bank is using Mambu's platform to handle its account, loan and credit solutions.

In describing the partnership, Orange Bank's CEO highlighted increased agility in building new products and quicker time to market as key benefits. This move is interpreted as a sign that the bank intends to deploy a single banking platform across Europe.

Lloyds Banking Group launching program to find FinTech partners

Lloyds Banking Group unveiled a 12-week program to expand its collaboration with FinTechs and InsurTechs. The program presents a chance for these participants to learn from the bank, with access to senior management and subject matter experts. At its close, the most promising candidates will be invited to collaborate with Lloyds Banking Group with an eye toward a potential extended partnership.

Current program applicants may be eligible for Series B seed funding. A similar project in 2022 resulted in FinTech Caura receiving a £4 million investment at the program's conclusion.

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PYMNTS Intelligence

Impending Open Banking Rules Make Bank-FinTech Collaboration a Must

Banks' and FinTechs' pursuit of collaboration in recent years is an especially positive development, given that United States regulation around open banking likely will make it a necessity. In October, the Consumer Financial Protection Bureau (CFPB) unveiled an open banking framework that will have far-reaching consequences for both FinTechs and banks when it eventually goes into effect, potentially in 2024.

The CFPB's framework mandates that banks provide qualified third parties with access to consumer financial data — including settled and unsettled transaction and deposit data, consumers' personal information and other miscellaneous information — through the use of application programming interfaces (APIs), much as Europe has been doing for years now. Although the specifics may change by the time the rules go into effect, banks and FinTechs will need to rely on each other to ensure compliance.

2024

Anticipated year that the CFPB's open banking regulations **will go into effect**

6

Number of specific categories of data that banks will be required to share with authorized third parties

PYMNTS Intelligence

Banks will need FinTech help to ensure compliance with new open banking rules

The proposed rules will require banks to make certain information available via two API-accessible portals: one consumer-facing and the other offering third-party access. At present, however, many banks are unable to comply with the CFPB's requirements.

The reason is that the majority of banks are using legacy back-end systems that do not easily support such capabilities. Even outside the context of open banking, banks have had API difficulties. According to a recent study, 81% of surveyed banks cited a lack of API experience as a challenge when partnering with FinTechs.

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Open banking could create problems for banks that FinTechs are well-positioned to address.

81%

Portion of banks that cite a lack of API experience as a challenge to working with FinTechs

2

Number of API-accessible portals that banks will be required to set up to make data available to users and authorized third parties, respectively

Fortunately for banks, FinTechs can help. Because FinTechs use primarily cloud-based systems that are far more dynamic and customizable, they do not have the same challenges as banks in implementing APIs to make the most of open banking. Banks can thus leverage FinTechs' agile systems and technological expertise to comply with the CFPB's forthcoming rules, expand their customer bases and tailor products and services to consumers' individual needs.

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> **By collaborating with FinTechs, traditional banks gain access to emerging technologies, innovation and improved customer experiences. Meanwhile, FinTechs benefit from partnering with established banks by gaining regulatory expertise, financial resources and a larger customer base. This collaboration enables banks to accelerate their digital transformation and leverage FinTechs' agility and innovative mindset. Together, they are driving innovation, transforming financial services and creating a more seamless and personalized banking experience for customers.**

Banks can also help solve FinTechs' problems with open banking

The bank-FinTech relationship is a two-way street, with FinTechs also standing to benefit from closer ties to banks when U.S. open banking is instituted. Although FinTechs have the technology capabilities to meet open banking requirements, banks can help FinTechs in the areas of data security and compliance.

Unlike FinTechs, banks have spent decades implementing data security measures and, as regulated financial entities, must comply with rigorous privacy and safety rules. If third parties are ultimately held liable for misuses and abuses of sensitive data — as banks are advocating — FinTechs will be on the hook for ensuring that customer data is safe and secure. Banks can help them implement data security best practices to limit their potential risks.

CHARLIE YOUAKIM
CEO
sezzle

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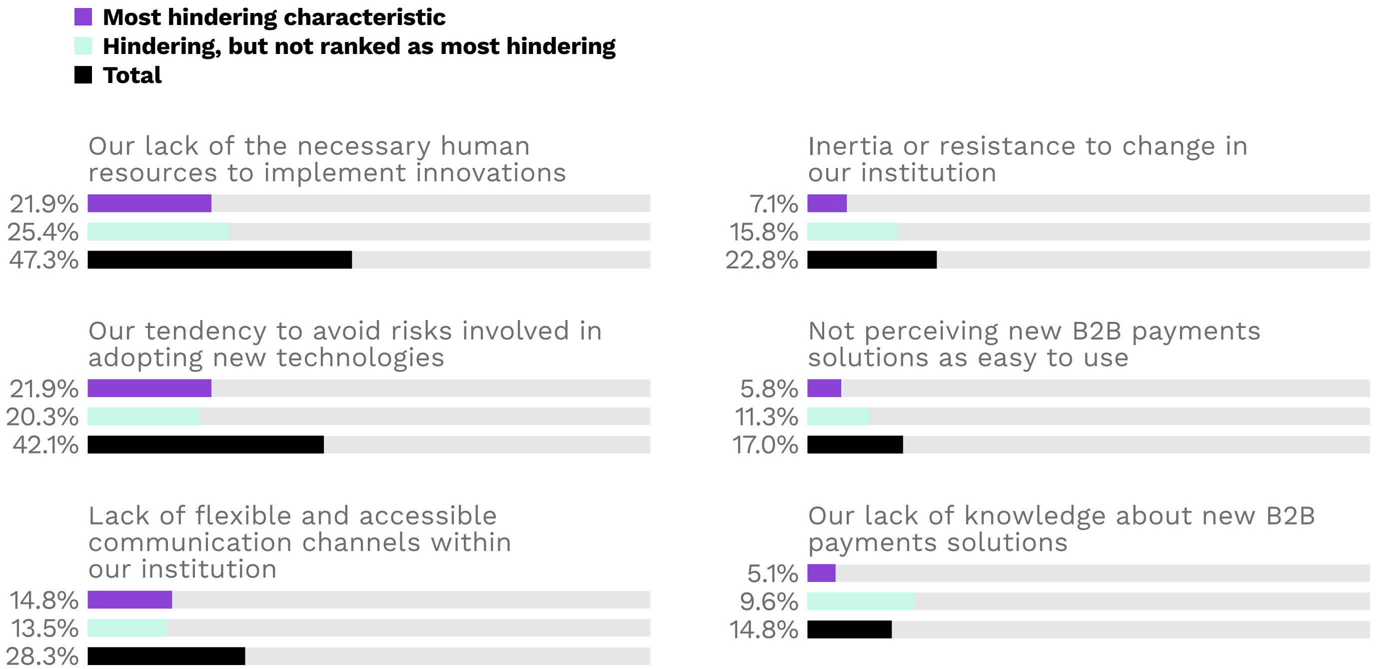
Chart of the Month

FIs Face Obstacles in Improving B2B Payments

A recent PYMNTS survey on [FIs' payment modernization efforts](#) reveals why many FIs need FinTechs' help to stay competitive in an increasingly digital world. When asked what was hindering their ability to address business-to-business (B2B) payment frictions, nearly 22% of FIs cited a lack of human resources and an aversion to risk associated with adopting new technologies as their top obstacles. A substantial portion of FIs also identified a lack of flexibility as a leading hindrance.

Characteristics holding back FIs' adoption of digital solutions to address B2B payment frictions

Share of respondents who identify characteristics hindering FIs' adoption of new digital solutions to address B2B payment frictions



Source: PYMNTS

Meeting the Challenge of Payments Modernization: How Organizational Size Influences Innovation, May 2022

N = 311: Complete responses, fielded Oct. 28, 2021 – Nov. 30, 2021

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Insider POV

An Industry Insider on the Growing Importance of Compliance in Bank-FinTech Relationships

KIRAN HEBBAR
CFO

ALLOY

"Fraud has exploded, [meaning that in 2023,] there will be stringent oversight on bank-FinTech relationships."

With fraud on the rise, an industry insider explains why regulators will ramp up scrutiny of bank-FinTech relationships.

Fraud has long been a troublesome problem for banks and other financial service providers — and it has only gotten worse. This dynamic could have a big impact on banks and their FinTech partners as the year unfolds, according to Kiran Hebbar, CFO at identity decisioning platform Alloy.

In an interview with PYMNTS, Hebbar explained that last year's profusion of fraud has prompted regulators to increase their oversight of bank-FinTech relationships this year, meaning that both parties may need to reevaluate their fraud-fighting capabilities.

The fraud prevention efforts of the past are no longer able to keep up with the current level and nature of threats, he said. As an example, rules-based fraud detection and prevention platforms, long a staple of fraud mitigation measures, are simply outmatched by the volume and increasing sophistication of attacks.

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Insider POV

These attacks are not limited to external fraud, either. The FTX implosion, Hebbar asserted, demonstrated the significance of internal fraud, and as the case's impact has fanned out across the crypto space, calls have grown for increasing scrutiny of FIs' and FinTechs' participation in this emerging area of payments, banking and finance.

Compliance could be a major problem for FinTechs. Because FinTechs typically are not used to operating in strict regulatory environments, regulators are starting to embrace a more proactive posture to ensure successful anti-fraud measures. This may require FinTechs to place a greater primacy on compliance and fraud prevention.

"What's needed in this modern world is a holistic approach to solving fraud," Hebbar said.

He added that technology will be central to this new strategy, and this is why firms such as Alloy are working with banks and their FinTech partners to bolster their compliance and security capabilities.

"There will be a new operating environment for many companies [in 2023 and beyond]," Hebbar said. "There will be a focus on improving efficiency and profitability ... and prioritizing fraud and compliance. Compliance needs to be built into the fabric of every company."

Regulators are increasing their scrutiny of bank-FinTech partnerships due to growing fraud concerns.

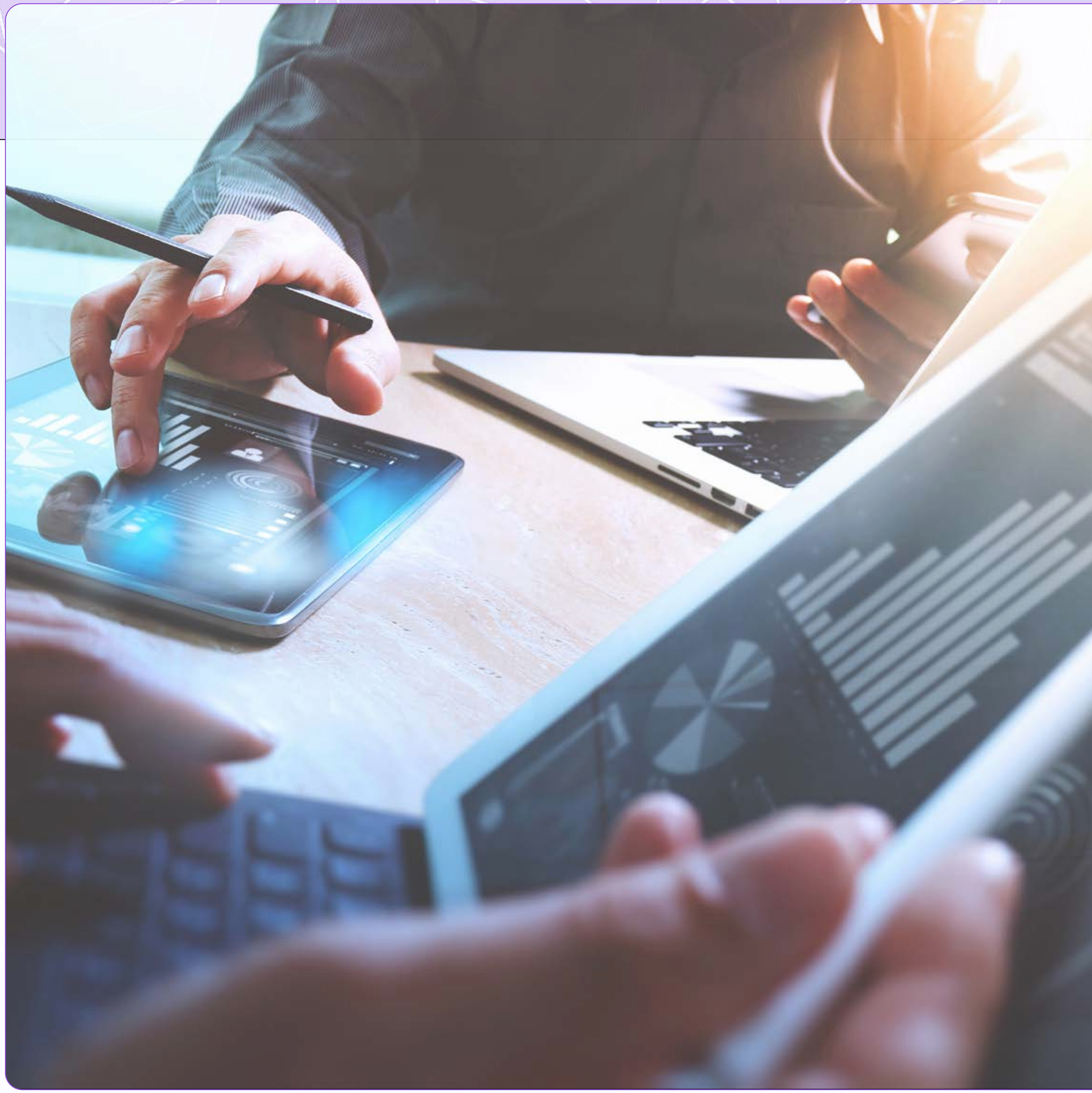
Fraud attacks are becoming more common and sophisticated.

The FTX scandal exposed how more safeguards may be needed to ensure compliance and tamp down on fraud.

What's Next

FinTechs and Banks Will Keep Collaborating

The dynamics driving FinTechs and traditional banks to work together are expected to continue, so the bank-FinTech relationship will continue to broaden. With consumers handling more of their financial needs online, the global market for banking system software is expected to expand to $46.8 billion by 2028, creating additional opportunities for everybody to participate.



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