FinTech: From disrupter to partner

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Letter from the Editor

Banks and FinTechs, getting in step

For much of the last decade, FinTechs and financial institutions have too often played the roles of suspicious neighbors, starring over the fence at each other, trying to read minds and break hearts. Banks in some cases wondered whether the grass would soon be greener in the FinTech yard (and if you want to equate green with revenue, please feel free).

FinTechs, meanwhile, dreamt of the day they’d take over the next-door plot and subsequently, the plot for world domination. If FinTechs were “disrupting” the neighborhood calm, they certainly didn’t keep quiet about it, and in some cases bragged about it.

But attitudes and circumstances have changed. Dramatically. And while there’s still a good amount of revolution going on, some FinTechs have found their ambitions disrupted, if you will.

To that end, BAI contributor Jeanne Pinder writes that in 2007, the peer-to-peer loan service LendingClub arrived with its French CEO-founder Renaud Laplanche confidently predicting that “directly connecting borrowers with lenders would lead to the demise of traditional bank loans.” Yet by 2017, Laplanche was gone after it was learned that “some loans had not met investors’ criteria... The company’s stock is down 77 percent since it went public in 2014, sitting somewhere around $5 per share. Lesson learned? Going forward, perhaps peer-to-peer lenders will need banks and their cautious attention to detail a lot more than they’d like to think.”

Yes, FinTechs need banks. But rather than return gloat for gloat, smart banks are seeking out FinTechs to achieve remarkable results. Anne Rawland Gabriel tells of how North Carolina’s Southern Bank revived its moribund checking account portfolio, using a partnership with a startup called StrategyCorps to create a Groupon-like online loyalty model. Southern began to offer valuable discounts for customers who signed up for fee-based accounts, and as Gabriel writes, “This not only stopped the bank’s bleeding. It began to boost revenues as well.”

Pinder also looks at the worldwide FinTech scene in her piece “FinTernational: Six global FinTech hotbeds.” Picking just a half dozen locations will always prove a daunting task, but Pinder casts a compelling spotlight in how London’s holding on (despite Brexit fears); Singapore is asserting itself as “Asia’s Tiny Tiger”; and Atlanta (a.k.a. “Hotlanta”) has heated up as a dominant payments hub. That good news comes just as we’re hunkering down for our second annual BAI Beacon conference, which will take place in Atlanta Oct. 4 and 5.

Of course, FinTechs can expect to lead the charge in a host of areas crucial to financial services: from artificial intelligence to cybersecurity; Internet of Things tech to alternative payment streams. But banks house some incredible minds to rival those in the high-tech field, and what’s more have institutional wisdom and compliance-regulation know-how that FinTechs lack.

In 2017, let’s hope the brash stance of disruption as destruction gives way to progress by way of partnership. It’s time to take the fences down and work together to create hospitable, profitable turf for all.

A veteran journalist who has served with the Chicago Tribune, Reuters Money and U.S. News & World Report, Lou Carlozo is the managing editor of BAI. Connect with him on LinkedIn.
When the peer-to-peer loan service LendingClub arrived in 2007, many envisioned a major disruption to the bank loan business as we knew it. What next: Lending money on Facebook? (Talk about an excuse for consumers to press the “like” button.)

Amidst the speculation, some industry leaders put their ear to the ground and heard the low rumble of tech-savvy, nimble, flexible lenders preparing to outflank banks—much of it drummed up by LendingClub’s French CEO-founder Renaud Laplanche, a charmer who boldly predicted that directly connecting borrowers with lenders would lead to the demise of traditional bank loans.

And as the financial crisis wore on, such vibrations only intensified. Added regulations made established institutions more complicated and sludgy—while LendingClub wannabees with different business models and slick, tech-savvy interfaces cascaded into the market.

Yet, despite predictions that peer-to-peer would run roughshod over traditional banks, the forecast 10 years on isn’t nearly so drastic. Facebook did get into payments via its Messenger service in 2016, but continues to refute any suggestion it will enter the loan market. Meanwhile, it’s clear banks now see opportunities as they look at peer-to-peer players. But what do these opportunities look like, and how can banks take part?

Peer-to-peer in 2017: Sizing up the market

Since LendingClub bowed, peer-to-peer has evolved into marketplace or alternative lending. More institutional investors, and even banks themselves, increasingly finance today’s loans. Thus compared to 2007, LendingClub can now create a market for retail investors to purchase notes, while balance-sheet lenders such as SoFi, OnDeck and Kabbage/Karrot can keep loans on their balance sheets until they find investors.

The common thread: The alternative lenders, many based in Silicon Valley or Silicon Alley, are tech-driven and agile—and often promise lightning-quick approvals delivered via smooth user interfaces.

The alternative share of the lending market is not huge, compared to the traditional lending market, though it has grown quickly. And, alternative presents “a tremendous opportunity,” say Rohit Kumar and Rashmi Singh of Ernst & Young. The two were among the co-authors of a recent paper, “Alternative Lending.”

For example, the entire mortgage market in the U.S. is worth upwards of $1 trillion, the report says, while alternative lenders have an $800 million share. Of the consumer lending market of $450 billion, $15.4 billion belongs to alternative lenders, the report says.

The marketplace lenders operate in many spheres, such as:

- **Mortgage lending** (Quicken Loans as well as Lending Home, Realty Mogul)
- **Consumer loans** (LendingClub, Prosper, Avant)
- **Student loans** (SoFi and Common Bond)
- **Small and medium enterprises** (OnDeck and American Express)

Peering into peer-to-peer:
As banks spy the online loan landscape, a new vision

By Jeanne Pinder

It took ten years for doomsday predictions to fade. So how can banks learn from and partner with marketplace lenders?
Potential partnerships
Marketplace and traditional lenders can partner at various points in the lending cycle. A marketplace lender might, for example, originate loans for a bank, or make a technology partnership with a bank for underwriting—since the alternative lenders generally claim their underwriting is faster and has less friction. Banks and more traditional lenders are able to securitize and fund loans for alternative lenders.

Strategic partnerships are a fast-growing segment. J.P. Morgan Chase has partnered with marketplace lender OnDeck, and Chase and Intuit drive more than 80 percent of referrals for OnDeck, according to the Ernst & Young report.

This graphic from a recent Deloitte report titled “Marketplace Lenders and Banks: An Inevitable Convergence?” gives insight into the various possibilities.

“Most folks don’t actually have a very good feeling for how regulated they will or won’t be 12 months from now. So, no one wants to make big bets when they don’t know what level of control they’ll have to put in place.”

Leo Loomie, vice president at Digital Risk

Tiffany Johnston, who currently leads Deloitte Consulting’s Lending Center of Practice (which focuses on lending innovation and excellence in lending), cited three areas where marketplace lenders are doing really well—and that the banks have to figure out:

The first: the marketplace lenders’ smooth digital experience and agility. “How do you own that customer?” Johnston asks. “How do you create an experience and a value proposition with your products and solutions that really means your customer wants to deal with you?”

The second: the potential for bank platforms that match borrowers with funders. “That’s where there are a lot of opportunities for banks to partner with existing entities,” she says. “Our projection is that some of the marketplace lenders with good platforms will fail, and banks might buy them.” To do that, however, she pointed out that failure-averse banks will need to be comfortable thinking like startups, to “fail small and fail fast.”

The third: data. Marketplace lenders use expanded data on trends and so forth, which the banks have but seldom “actually activate it for the benefit of their clients, or their customers.” Or if they do, it’s not as well as the marketplace competition.

Kumar and Singh also note that marketplace lenders give banks access to additional customers, often in segments banks cannot serve profitably or have trouble serving, such as the underbanked, including students or people with subprime credit.

Cautions: from culture to controls
But there are cautionary notes as well. Kumar and Singh point out that bank regulation is very different from the regulation of marketplace lenders. In any relationship, both parties need to take that into account. What’s more, technology platforms and cultures may not mix well.

Also, they pointed out, the underwriting strategies are very different. The banks often use proprietary credit-scoring technology to underwrite loans, while FinTechs such as SoFi employ an “ability to repay” assessment of a borrower. It specifically excludes a FICO score in favor of factors such as a borrower’s current cash flow and future earnings potential.

Regulation is also a big issue that makes banks cautious, says Leo Loomie, vice president at Digital Risk:

“There’s a lot of regulatory uncertainty in the market as a whole right now,” Loomie says, pointing to the future of Dodd-Frank financial regulations. “Most folks don’t actually have a very good feeling for how regulated they will or won’t be 12 months from now. So, no one wants to make big bets when they don’t know what level of control they’ll have to put in place.”

Nor do the big banks have any idea how marketplace lenders would survive a down cycle. LendingClub and OnDeck both reported dismal fourth quarter results recently, sending a chill through the industry.

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“The question is whether these lenders have the discipline to stay the course and not make bad lending decisions,” Johnson notes. “The suspicion is that when there is another downturn—which there will be, because there always is—that some of these guys are going to have such losses that they don’t survive.”

And so that perceived initial threat posed by LendingClub’s arrival has come somewhat full circle in 2017. Following that bad fourth quarter, LendingClub revealed that some loans had not met investors’ criteria, resulting in Laplanche’s resignation in May. The company’s stock is down 77 percent since it went public in 2014, sitting somewhere around $5 per share.

Lesson learned? Going forward, perhaps peer-to-peer lenders will need banks and their cautious attention to detail a lot more than they’d like to think.
Our torrid affair with Groupon has always been a love-hate thing: The more consumers embraced it, the more businesses discovered it was just another form of pay-to-play. That, and outflanking by copycat discount sites, explains in large part why Groupon stock eventually tanked and CEO Andrew Mason was forced out of the company he created.

But where Groupon weathered many setbacks (from which it’s never bounced back), banks can learn from and tweak the company’s revolutionary model. Consider Southern Bank, a 116-year old institution headquartered in Mount Olive, N.C. Its early and prescient FinTech partnership paved the way for something unique: a suite of revenue-generating checking products that delight consumers and support local merchants.

To lift sagging account performance, Southern Bank enlisted a Groupon-like service that freed it from the free checking dilemma.

From deals on checking to deals through checking: How one bank leveraged FinTech for a major account win

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The story begins in 2007, when free checking was ubiquitous—except at Southern. Reluctant to cannibalize the non-interest income its traditional retail checking portfolio generated, Southern was hemorrhaging roughly 100 checking accounts per month.

“At the time, industry averages showed that introducing a free checking product attracted about 85 percent of new account openings,” recalls John Heeden, Southern’s senior vice president and marketing director. “We delayed free checking because we wanted to offer a viable and credible alternative.”

From a checking reality check to inspired FinTech

Enter StrategyCorps, a 2001 startup offering a new type of turnkey online loyalty program called Member Headquarters. It works much like Groupon, with consumers netting discounts from several hundred thousand businesses, in categories ranging from food to travel.

Besides offering access to national name brands, the StrategyCorps model includes a local merchant procurement program that leverages a dedicated acquisition team to seek out new businesses—at no cost to the bank.

Likewise, participation for merchants costs nothing beyond the spiff and swag they offer consumers (for example, a free fountain beverage at a convenience store with a gasoline minimum purchase).

And beyond anything Groupon had ever provided, Member Headquarters offered identity theft protection as an early perk. This addressed a burgeoning consumer angst a decade hence, and could help Southern Bank show its customers that it fully understood a matter of great concern to them.

Diving for dollars

With all this potentially working in the bank’s favor, Southern took the plunge. It revised its portfolio to offer fee-based options that featured Member Headquarters, alongside a single free checking product. This not only stopped the bank’s bleeding. It began to boost revenues as well.

“When we first launched Member Headquarters, roughly a third of customers would choose one of the options,” he says. “We charged a nominal fee for those products and kept most of it.”

During subsequent years, they expanded to include benefits such as identity theft monitoring, roadside assistance, cell phone protection, and a savings program for pharmacy, vision and hearing services. Other innovations included the launch of an analytics tool to quantify the value of existing checking relationships. And as a watershed, it introduced an updated app-centric version of the deals-and-discounts loyalty platform in 2012, dubbed BaZing.

Yet Southern only adopted new options as they made sense. For example, Southern’s demographic skewed too rural and mature to immediately embrace the app. As the bank evaluated what to do, it stayed with the Member Headquarters platform while adding other loyalty benefits.

Each time, the ratio of loyalty-based accounts rose.

And BaZing goes on

By late 2013, market and industry dynamics had sufficiently shifted. “We knew it was time to revisit our account offerings so we decided to take a second look,” says Heeden.

Using CheckingScore to provide a quantitative analysis, Southern determined it could optimize its...
From deals on checking to deals through checking: How one bank leveraged FinTech for a major account win

checking products by dropping free checking while also upgrading small and low-performing accounts to a StrategyCorps-enabled product in mid-2014.

“The analysis proved very accurate in forecasting outcomes,” says Heeden. “Our increase in non-interest income tracked almost exactly where it was forecasted, at about an 80 percent lift. Account attrition levels were far less than modeled.”

In addition to restructuring its checking portfolio, Southern also shed Member Headquarters in favor of BaZing. New accounts selecting an application-enabled product rocketed up to 85 percent, a level that remains today.

Meanwhile, StrategyCorps continues to update the application with bank-favorable features. For instance, whenever a consumer opens the app, they see a running total of how much Southern has helped them save. Most recently, new location-awareness capabilities enable the app to push merchant offers to users based on their current position, whether they’re near home or miles away.

As for Southern, it offers two tiers of accounts that cost $6 or $7 per month. “We include a 90-day free trial on our BaZing-related products,” says Heeden. “Only a fraction of people decided it’s not for them.”

On the merchant side, Southern presents the application as a benefit. “When our business bankers call on prospects they pull out their smartphone, demonstrate the app and suggest the business could offer a deal,” says Heeden. “It’s a value-add, especially when we move into a new banking market—where scoring points with the small business community is always a plus.”

Stickiness, strategy:
The Southern sky’s the limit

Overall, Southern’s partnership with StrategyCorps continues to evolve and thrive. “Our BaZing offerings are definitely stickier,” says Heeden. “The CheckingScore analysis was advantageous and worth considering again in the future.

“Most importantly,” he adds, “we’ve grown our non-interest income significantly over time.”

For the bank, its customers and participating businesses, it’s just the kind of triple win that could teach the struggling Groupon brass a thing or two—or three.
When the FinTech startups burst onto the U.S. scene around the time of the financial crisis in 2007-08, the image was one of young Silicon Valley and Silicon Alley tech bros ready to put aging, creaky necktie-wearing bankers and their businesses out to pasture.

But here’s what happened instead: Global FinTech centers rose to challenge the supremacy of San Francisco and points beyond. Overseas, government attitudes on regulation have fostered an environment for FinTechs to grow and collaborate. And at home, some cities have quietly laid the groundwork to encourage FinTech growth away from the spotlight—but now worth spotlighting. Here are six of those leading and growing global centers.

London’s edge is falling down? Not yet.

London’s ascendance as a global center of FinTech was challenged by no one—until the Brexit vote. And now it’s all up in the air, especially with the British Prime Minister’s stunning defeat in June’s general election that wiped out her Conservative majority in Parliament, and has put key parts of her Brexit agenda in jeopardy.

Meanwhile, innovation is still booming in London, said Rohit Arora, CEO of marketplace lending site Biz2Credit.com, which connects entrepreneurs with loan options. He pointed to a few challenger banks—in mobile-first FinTech, for example—that allow innovators to launch services they couldn’t in the U.S. because of the regulatory environment. (One such financial institution is Starling Bank, the first mobile-only bank in Europe and featured on the BAI Banking Strategies podcast.)

“Thats one big plus London still has,” Arora says. “Innovation is still going on, but the uncertainty over Brexit will not get resolved anytime soon.” Institutions based in London, for example, will not have full access to the full EU market, and are grappling with great uncertainty over bringing in non-UK citizens to work.

The UK is also working hard to foster startup investment through initiatives such as the Enterprise Investment Scheme (EIS), a series of tax relief statutes dating from the 1990s. Through the EIS, high net worth investors are incentivized to invest in small, early-stage companies, said Matt Schaffnit, co-founder and chief operating officer of Lending Technologies Corp, a customer acquisition management tool that helps lenders target, acquire, onboard and retain small and medium enterprise borrowers.

Schaffnit also notes that the Financial Conduct Authority Sandbox in the UK, which launched in 2016, allows businesses to test new ideas without all the normal regulatory consequences: for example, facilitating blockchain trials in a government-supported ecosystem that nurtures innovation.

Participants in the first sandbox round included HSBC and Lloyd’s Banking Group, as well as multiple blockchain companies such as Luno (formerly BitX), a cross-border money transfer service powered by digital currencies and blockchain technology. Also making the cut was Nextday Property, a nascent startup that provides interest-free internet loans for a guaranteed amount to customers who can’t sell their property within 90 days.

Berlin and Geneva: Europe’s upwardly mobile

Germany is jumping to be the “not London,” with Berlin now one of the hottest tech centers in Europe, if not the hottest, Schaffnit says. And as a very sexy place to live, Berlin attracts young tech talent.
Switzerland, a traditional stronghold of banking technology and secrecy, has also seen a leap in blockchain and cryptocurrency, in the spirit of the nation that's home to the famously anonymous Swiss bank account. The action centers on Geneva, which hosts FinTech FUSION, a prestigious assembly of 10 global FinTech startups handpicked for a 12-month accelerator program.

“There has been an active regulatory scene to create and support innovation for blockchain and FinTech in general,” in Switzerland, says Aaron Schwartz, head of FinTech research at DeNovo, PwC’s proprietary FinTech intelligence platform. He points to a 2016 proposal that made it easier for blockchain startups to hold assets without being classified as a bank, and hence having to negotiate the associated regulatory restrictions.

**Singapore: Asia’s tiny tiger**

In Asia, the talk has often been of Shanghai’s ascendance. But China’s lack of transparency, closed market and the uncertain political climate make FinTechs leery of going there, Schwartz said. But Singapore’s regulatory body and central bank, the Monetary Authority of Singapore (MAS), has thrown its support behind both FinTech and RegTech. The interesting juxtaposition with the latter is that the relaxed regulatory stance of MAS is helping develop technology that lightens the burden of regulatory requirements.

All of this is making this city-state of just 5.8 million people a FinTech force to reckon with. Schwartz says that Singapore is turning RegTech from a reactive, backward-looking function (“the principal tells you that you have to stay after school”) to a proactive one ingrained in the business. It uses cognitive computing, for example, to monitor and detect suspicious trading as a form of employee surveillance.

“RegTech is an area where you have to have regulators embrace the technology to move it forward,” he said, and having the MAS act as a champion has helped Singapore emerge as a leader.

Singapore has also created its own sandbox geared towards keeping FinTech business at home. The overarching goal is to create an ecosystem where banks, FinTechs and regulators can work together.

**India: Mumbai, Bangalore, and the ‘India Stack’**

Arora also pointed to the boom in India, which features two strong FinTech scenes: Mumbai as the financial hub and Bangalore as the tech hub. Here, demonetization in 2016 pushed digital adoption on the payment, lending and data fronts.

Mobile wallet players such as Paytm won big as digital payments profited from the “India Stack”—a set of application programming interfaces (APIs) that allow government, businesses, startups and developers to use a digital infrastructure that has moved the nation “towards presence-less, paperless, and cashless service delivery,” as the IndiaStack website says. Individuals are assigned unique identification numbers to make digital transactions quick and secure, let the unbanked join the monetary system, and transform business and government delivery of services and goods.

Yet India has some growing up to do. Its infrastructure is still weak, Arora notes. India’s connectivity is still rising to meet world standards and its integration into world markets lags behind global centers such as London and New York.

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    Banks have long leaned on a customer ecosystem now undergoing sea change. The Internet of Things offers a chance to test new waters first.

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**Atlanta: Heating up into ‘Hotlanta’**

The presence of tech talent, academics and/or government regulatory support help drive US hotbeds, Schwartz says. He cites the traditional examples: Silicon Valley (tech talent and Stanford University), New York (tech talent, academics and multiple industry hubs), Boston (M.I.T. and Harvard) and the Washington, D.C. area (government and regulatory).

But there’s also a surprise guest: Atlanta, a center of payments technology. The city will also host BAI Beacon on Oct. 4 and 5.

“Atlanta and Georgia are the most significant places for debit and credit card processing”—handling between 70 and 80 percent of domestic transactions, says Larry Williams, president of the financial industry group of the Technology Association of Georgia (TAG). “It’s the part of the process that most people never see as we swipe strips or insert chips, and it’s all enabled right here.”

Williams adds that Atlanta’s story is not increased collaboration between FinTechs and banks, but part of an overarching narrative integral to the region’s overall success: “You have this great intersection of companies that have abilities, and also the companies using the technology.”

There’s also lots of infrastructure here—the fiber optic kind—and several other elements making FinTech magic.

Major companies either grown in Atlanta or transplanted there that need payment and other FinTech solutions (UPS, Home Depot, Coca-Cola and Equifax among them).

About 100 companies involved in payment processing (such as Global Payments, NCR and First Data)

About 90 startups (including Kabbage and Goins)

Educational institutions that supply engineering talent such as Georgia Tech, Kennesaw State, Emory and the University of Georgia)

Most Atlanta FinTechs collaborate exceedingly well with banks and the vast majority making big profits “are working on the rails that are already there,” Williams says.

Yet Atlanta’s FinTech train has hardly left the station—new ones, in fact, seem to pull in constantly.

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Jeanne Pinder is the founder of ClearHealthCosts.com, an award-winning startup bringing transparency to the health care marketplace. She was an editor, reporter and human resources executive at The New York Times for close to 25 years, and has also worked at the Des Moines Register, Associated Press and Grinnell Herald-Register.
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