Fintech and Compliance – Partnering for Success

Steven Ramirez, CEO – Beyond the Arc
Please note:
This course does not provide legal or compliance advice. You should discuss these topics with the appropriate subject matter experts at your financial institution.
“Banks and FinTech companies partnering up yields the best from both worlds — boosting the industry with new innovative services from a trusted institutional partner. Each side directly benefits in carving a new niche AND gaining a wider reach of clientele — delivering advantages of cutting costs, increasing revenue, and enhancing customer satisfaction.”

Source: How FinTech Partnerships with Banks Shape the Future of Finance, FINTTECHTRIS
Welcome

- Describe what fintech is, its benefits and risks
- Identify ways to assess your institution’s readiness to partner and select the right fintech partner
- Involve your compliance officer early on
- Prepare to take steps for managing compliance and risk
- Recognize that technology changes quickly and what that means for your institution
What we’ll cover today

Preparation

- Fintech overview
- Getting ready to partner
- Managing compliance and risk

so you can make smart decisions with clarity and confidence.
What we’ll cover today, continued

Implementation and beyond

Implementing your fintech solution
Preparing for new technologies
Summary & resources

...and enhance your results with knowledge and preparation.
Fintech overview
What is fintech?

Fintech = financial services + technology

Fintech is:

• An enabler of digital transformation, providing a way of doing business differently.

• About applying technology solutions to achieve a customer-centric operating model.

• A mindset that takes advantage of technology, business processes, and new skills and capabilities to bring fresh perspectives for meeting people’s financial needs.
Fintech covers a range of solutions, including:

- Payment apps
- Advanced analytics and big data
- Artificial intelligence
- Omnichannel access
- Internet of Everything
### Types of fintech solutions - examples

Solutions can be customer-oriented or provide internal efficiencies.

<table>
<thead>
<tr>
<th>Customer oriented</th>
<th>Internally oriented</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Digital account opening</td>
<td>• Distributed ledger technology (for cost savings)</td>
</tr>
<tr>
<td>• Customer onboarding</td>
<td>• Back office process automation</td>
</tr>
<tr>
<td>• Authentication and Know Your Customer (KYC)</td>
<td>• Fraud detection</td>
</tr>
<tr>
<td>• e-docs, e-signatures</td>
<td>• Small business loan platform</td>
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<tr>
<td>• Marketing and email automation</td>
<td>• Accounts payable automation</td>
</tr>
<tr>
<td>• Customer Relationship Management (CRM) system</td>
<td>• Document management and imaging</td>
</tr>
<tr>
<td>• Personal Financial Management</td>
<td>• Regtech and compliance systems</td>
</tr>
<tr>
<td>• Card controls and geo fencing (limits credit / debit card use outside a geographic area)</td>
<td>• Automated programming interfaces (APIs) and payment gateways</td>
</tr>
<tr>
<td>• AI and related automation technology</td>
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</table>
Regtech can help you manage risk

There are fintech solutions that help you better manage risk and compliance. These are called “RegTech.”

Examples include:

- AI-driven database that generates profiles, automates customer monitoring, and screens payments as they occur
- Big data tools to detect fraud and money laundering, delete fake accounts
- Compliance tools to manage new regulations, calculate risk, and develop strategy
- Customer consent and data rights management platform
- AI-driven platform to find and store rules and regulations from regulatory agencies affecting FIs
Partnering provides benefits to FIs

FIs can:

• Access new tools and technology
• Add innovations that attract and retain customers
• Generate new sources of revenue
• Gain operational efficiencies
• Experiment with new business models
• Reach new customer segments with new products and services
• Reduce reliance on core providers and increase flexibility and resilience through use of APIs
• Learning from the fintechs

Benefits banks see in collaborating with fintech companies:

- Enhanced brand reputation: 36%
- Expanded mobile banking functions: 59%
- Lower capital expenditures: 44%
- Lower cost of doing business: 42%
- Increased access to consumers in new markets: 8%
- Increased access to younger consumers: 11%

Source: Mannat © November 2016 The Financial Brand
Partnering also provides benefits to fintechs

Benefits include:

- Revenue and company growth
- Access to FI’s customer base and insured deposits
- Use FI’s payment settlement systems
- Leverage FI’s regulatory infrastructures
- Offer complementary services
- Learning from the banks
Balancing innovation and risk

While fintech innovations can enhance the delivery of financial products and services, risks include:

- Breach in data security for customers or financial institution
- Fraud
- Faulty integration with bank systems
- Operating risk
- Reputation risk

As a result, you need to balance innovation with risk management.
Getting ready to partner
Section overview

We’ll cover:

• Determining your readiness to partner with the “5 R’s”
• Creating your shortlist of potential fintech partners
• Assessing partners with a scorecard
• Involving compliance early on
• Building a relationship with your fintech partner
5. Right timing – Given other strategic initiatives, how does this solution fit in?

1. Right strategy – What problem are you trying to solve?

4. Right support – What outside and internal expertise do you need to help evaluate the options? How can you gain internal support?

2. Right business case – Does the technology meet your needs for customer experience, functionality, cost, increased efficiency, or making or saving money?

3. Right solution – Build vs. buy? Price per user or monthly subscription fee? Is your IT governance up to date for the cloud, mobile and other tech?

Determine your FI’s readiness with Beyond the Arc’s 5-Rs

Source: Beyond the Arc
1. **Right strategy**

Before you begin to explore a new technology, **clarify what problem you’re trying to solve**. Start by selecting a major pain point or business opportunity for your financial institution.

For example:

- Meet an unmet customer need (e.g., as revealed by your Voice of the Customer program)
- Deliver a better customer experience with enhanced security, speed, or convenience
- Add value through advice or planning tools
- Increase personalization using customer and business data and applying advanced analytics
- Solve an industry-wide challenge, such as personalization
2. **Right business case**

Determine what you want from the new technology and if it’s worthwhile in terms of fit, process and people.

Does the new solution...

- **Fit** – with the problem/opportunity, your budget, or provide an advantage to you?
- **Process** –
  - Smoothly integrate with your existing processes and technology stack; support expected volumes?
  - Do you need to modify your existing frameworks for risk and compliance?
- **People** – have the specialized expertise? Provide support to think/work differently?
Given your budget, operations, and any system constraints, does the new technology have the potential to provide the right solution?

Consider a range of factors, including:

- Total cost of ownership
- Build vs. buy
- One-time and annual costs
- Pricing per user vs. monthly subscription
- Proprietary software vs. free/low cost open source alternative
- Status of your IT governance for cloud, mobile, and other new technologies
- Future upgrades – will you need to pay, and if so, how much
The next step in your analysis is to determine whether you have the right support to move forward from:

- Outside experts
- In-house staff - e.g., IT/Tech, SMEs, Legal and Compliance, CX
- Leadership

Are there skill gaps, such as:

- Business model development – identifying new ways to make money?
- Acquiring customers that are different than your existing customer base?
- IT skills that emphasize working with APIs and open systems?
- Data science and machine learning that create insights you can act on?
5. **Right timing**

Even if the previous 4-R’s indicate a “go”, you’ll also need to consider other priorities at your institution.

- Given these, is this the right timing for a new technology?

Additionally, how much change are employees experiencing?

- Will they have the capacity to deal with changes resulting from this technology solution?

- What training will you need to help ensure a smooth transition?

- How will you follow-up with internal communications to build momentum?
Now you’re ready to select the right fintech partner

Once you’ve identified potential fintech partners, you’ll need to consider:

- Cultural fit – with your institution; shared values?
- Cost – is it within your budget?
- Time in business – how long?
- Attitude toward risk – is the fintech willing to address regulatory needs?
- Areas of expertise – are your requests outside their capabilities?
- Track record – does the fintech have past successes?
- Geography – in a different time zone? available to meet onsite?
# Create a vendor shortlist

Your shortlist includes vendors meeting most or all your key criteria.

<table>
<thead>
<tr>
<th>Fintech Name</th>
<th>Cultural Fit (with your institution)</th>
<th>Cost ($, $$, $$$)</th>
<th>Time in Business</th>
<th>Attitude toward Risk</th>
<th>Prepared to Partner w/ You</th>
<th>Track Record (past performance)</th>
<th>Notes and observations (optional)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
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<td></td>
</tr>
</tbody>
</table>
# Create a vendor shortlist - example

Your shortlist includes vendors meeting most or all your key criteria.

<table>
<thead>
<tr>
<th>Fintech Name</th>
<th>Cultural Fit</th>
<th>Cost ($ amount)</th>
<th>Time in Business</th>
<th>Attitude toward Risk</th>
<th>Prepared to Partner w/ You</th>
<th>Track Record</th>
<th>Notes and observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. X-elerators*</td>
<td>Fairly good fit – may take some time to adjust to each other</td>
<td>$$$ for pilot – you own solution</td>
<td>3.5 years</td>
<td>Appreciates bank regulation, but may need coaching</td>
<td>Need several months’ lead time</td>
<td>2-3 prior successes</td>
<td>This company seems to have the deepest expertise in small business accounting.</td>
</tr>
<tr>
<td>2. B2B4U</td>
<td>Good fit with current culture – will they spur innovation?</td>
<td>$$ for pilot – they provide solution, you refer customers</td>
<td>5 years</td>
<td>Strong understanding of regulations</td>
<td>Ready now</td>
<td>&gt; 5 successes</td>
<td>This solution is already built.</td>
</tr>
<tr>
<td>3. Bring It On</td>
<td>Very different mindset - could add needed creativity or be a mismatch</td>
<td>$ for pilot – they own solution</td>
<td>1 year</td>
<td>Does what’s needed – “cowboys”</td>
<td>Like to go it alone – but are willing to partner</td>
<td>New firm</td>
<td>This company has the strongest technology team.</td>
</tr>
</tbody>
</table>

* Hypothetical examples, not actual fintechs
Prepare to evaluate with a scorecard

First, gather a range of information about your potential partner:

• Ability to deliver the new product or service solution
• Willingness and ability to meet your FI’s requirements (regulatory, risk, supply chain)
• Impact on your institution’s risk factors
• Does the fintech use external providers for technology or staffing?
• Research the partner online and make note of both positive and negative reviews
• Conduct interviews and consider site visits
Evaluate with a scorecard

Criteria, in addition to clear customer need

<table>
<thead>
<tr>
<th>Vendor Name:</th>
<th>Project:</th>
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<tbody>
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</tbody>
</table>

**Cultural Fit**

- Shared values with your FI?
- Understands your markets, customers?
  - Little alignment
  - Tight fit

**Cost**

- Estimated cost?
  - Consider:
    - Business model
    - Short term costs
    - Total cost of ownership

**Attitude Toward Risk**

- Understands bank risk?
  - Low ≤ 1
  - High ≥ 5

**Partner Readiness**

- How ready to partner?
  - Low = lone ranger
  - High = comfortable partnering
  - Low = need 6 months’ lead
  - High = ready soon

**Track Record**

- Past success?
  - New or mature firm?
  - Low = too new a firm
  - High = at least 2-3 prior successes

Source: Beyond the Arc
**Evaluate with a scorecard - example**

Criteria, in addition to clear customer need

<table>
<thead>
<tr>
<th>Vendor Name: Xelerators</th>
<th>Project: Bookkeeping solution for small business owners</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Cultural Fit</th>
<th>Cost</th>
<th>Attitude Toward Risk</th>
<th>Partner Readiness</th>
<th>Track Record</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cultural Fit</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

**Cultural Fit**
- Little alignment
- Tight fit

**Cost**
- Consider: Business model, Short term costs, Total cost of ownership
- Low ≤ 1
- High ≥ 8

**Attitude Toward Risk**
- Understands bank risk?
- Low = lone ranger
- High = comfortable partnering

**Partner Readiness**
- How ready to partner?
- Low = too new a firm
- High = at least 2-3 prior successes

**Track Record**
- Past success? New or mature firm?

**Notes**
- Receives a fair rating – needs 3 months’ lead time; not ready right away
- Fintech has successfully implemented this solution with 3 similar FIs

- Higher cost relative to other providers
- This fintech recognizes and values the importance of bank regulations; it will need some help to comply with them

- Shared values with your FI? Understands your markets, customers?
- Estimated cost?
Start small

With a:

• Pilot
• Proof of concept

You can scale up once you’ve proven the solution’s viability.

Expect that your work is iterative.

• Why? Because Fintech growth requires an ongoing process to spur a cycle of continuous improvement.
Be prepared to provide coaching to your fintech partner

Your fintech partnership should be more *relationship-based* than *vendor-based*.

Why? It’s likely you’ll need to help the fintech be successful. You can do this through coaching and mentoring. By investing in coaching and mentoring your fintech partner, you’ll be able to:

- Get to innovation more quickly
- Offer benefits to your customers in new ways

Coaching skills and behaviors include:

- Active listening
- Planning and joint problem solving
- Conflict resolution
- Educating, encouraging and appreciating
### Sample fintech discussion worksheet

<table>
<thead>
<tr>
<th>Topic</th>
<th>What to discuss</th>
</tr>
</thead>
</table>
| Security and compliance       | • Let’s make sure you’ve received our security and compliance requirements.  
                                 | • What is your plan to meet them?  
                                 | • How can we help?                                                                                                                                   |
| Training and documentation    | • What training will you provide on the new solution?  
                                 | • What documentation is available for our team?                                                                                                   |
| Support and future upgrades   | • Let’s discuss your plan to provide tech support. How do you plan to handle future upgrades?                                                   |
| Ongoing costs                 | • Let’s clarify costs for:  
                                 | o Software licensing  
                                 | o Support  
                                 | o Upgrades  
                                 | o Custom programming  
                                 | o Implementation services  
                                 | o User training  
                                 | o Anything else?                                                                                                                                |
Involve your compliance officer early on

- Get their support early in the process
- Discuss these key areas for managing risk:
  - Data security
  - Fraud prevention
  - Anti-money laundering
  - Consumer protections
  - Other areas of risk depending on your proposed solution, state, regulator, etc.
- Make them part of your team
- Ask if there are any other areas to assess as part of your evaluation criteria
- Involve outside experts as needed
Pro Tips

• Include compliance as an integral part of the partnering process
• Be willing to invest the time to help the fintech address potential hurdles
• Recognize that there is likely to be risk, and focus on mitigating and managing it vs. completely avoiding it
Managing compliance and risk
Set up practices for safely onboarding & clearing payments

• Apply anti-fraud practices, such as:
  o Comparing data on user behavior to suspicious patterns
  o Monitoring suspicious activities
  o Accessing criminal profile blacklists
  o Anti-spoofing
  o Monitoring transactions for chargeback fraud
  o Exposing fake photos/identities with AI

Source: The Power of the Right KYC/AML Compliance Routine in Fintech, Sum & Substance (this and next slide)
Set up practices for safely onboarding & clearing payments

• For customer onboarding and BSA/AML:
  o Apply *Know Your Customer, Know Your Business, Know Your Transaction* protocols
  o Follow Payment Services Directive 2 (PSD2)
    ▪ Work with Third Party Service Providers who are compliant with Regulatory Technical Standards to perform transactions
    ▪ PSD2 reinforces security with stronger customer authentication (e.g., one-time passwords, digital signature)
  o Anti-money laundering – appropriately apply three levels of compliance: *Simplified Due Diligence, Customer Due Diligence, Enhanced Due Diligence*
  o Recognize and address drawbacks that discourage onboarding
    ▪ E.g., unprocessed user-flow, multiple verification stages, manual filling of multiple data fields, lack of AML screening skill
OCC Guidance on Third Party-Relationships

Highlights - OCC Bulletin | 2013-29

• “An effective risk management process throughout the life cycle of the relationship includes:
  
  • plans that outline the bank’s strategy, identify the inherent risks of the activity, and detail how the bank selects, assesses, and oversees the third party.
  
  • proper due diligence in selecting a third party.
  
  • written contracts that outline the rights and responsibilities of all parties.
  
  • ongoing monitoring of the third party’s activities and performance.
  
  • contingency plans for terminating the relationship in an effective manner.
  
  • clear roles and responsibilities for overseeing and managing the relationship and risk management process.
  
  • Documentation and reporting that facilitates oversight, accountability, monitoring, and risk management.
  
  • Independent reviews that allow bank management to determine that the bank’s process aligns with its strategy and effectively manages risks.”

Source: Third-Party Relationship: Risk Management Guidance
Maintain consumer protections

If the fintech will be interacting with customers, be in sync on:

- UDAAP – avoiding these practices
- Reg E – especially for payments and mobile banking
- CANSPAM and other marketing compliance issues
- Data privacy
- ADA (Americans with Disabilities Act)
Provide security for customer and bank data

Talk to your experts about challenges, including:

• Online hacking and malware attacks – check for vulnerabilities in processes

• Application security risk – make sure fintech’s app has critical security features (e.g., “full-proof security modules and efficient codes”)

• Digital identity risks for mobile services – check fintech’s system and address any risks in your online security architecture

• Cloud-based security risks – ensure any cloud-based solutions a fintech provides have adequate security measures

Cybersecurity: 7 Hidden Risks of Fintech Industry, by Apoorv Gehlot, Payments Journal
Implementing your fintech solution
Lead and manage change

To help set the stage for success, you’ll need to create a change management plan, for example:

• Make sure you have an active and visible executive sponsor
• Share the vision - explain the rationale and benefits of the new technology
• Educate bank staff on new products and services
  • Take time to listen and understand any concerns; provide the necessary support
  • Determine which groups may have difficulty with the solution and plan how you will work with them
• Communicate frequently and clearly about upcoming changes and benefits
• Identify early adopters and gain their support
• Don’t let potential roadblocks paralyze your efforts
Monitor, measure, and adjust your efforts

- Implement the change
- Monitor and get feedback from customers and employees
- Capture learnings and adjust as needed
- Build on what you’ve learned
Preparing for new technologies
What you can do to prepare for new tech

• Technology is continually evolving
• Stay up-to-date on technology advances – consult with outside experts, as needed
• Be ready to leverage them as needed
• Partner with regulators to meet evolving customer and regulatory needs

Source: How Startups Are Disrupting the Financial Ecosystem, by G. Dautovic, Fortunly
Wrap-up
Recapping what we covered

- Partnering with a fintech can help you add tech innovations that attract and retain customers as well as gain operational efficiencies.
- Before partnering, assess your institution’s readiness and develop selection criteria.
- Compliance issues include safely onboarding customers, preventing fraud, and protecting customer and bank data.
- Including the compliance officer in your team early on is key to creating buy-in and support.
Partnering with a fintech requires a relationship-based approach

Compliance has to be baked in; you can’t do this at the end
“Building a compliance infrastructure is like building a house: If you lay the foundation correctly, you’ll avoid the cost of rebuilding in the future.”

Source: Financial institution regulations and fintech compliance: A two-fold approach to risk management, by Troy Snyder, James Siegel
BAI Tools and Resources

Articles

• Five questions to answer before starting a digital transformation
• Banking compliance and the 2020 CARES Act

Courses

• Considering a Fintech Partnership, 80100
• Selecting the Right Fintech Partner, 80101
• How to Assess Your Institution’s Readiness to Adopt a New Technology Solution, 80121
• Choosing the Right Vendor for Financial Institution Software, 80122
Third-Party Relationships:

- Risk Management Guidance
  OCC Bulletin 2013-29 | October 30, 2013

- Frequently Asked Questions to Supplement OCC Bulletin 2013-29
  OCC Bulletin 2020-10 | March 5, 2020
Thank You!

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Questions and Feedback

• Questions
• Feedback
• Contact contentandproduction@bai.org