The Banking and Fintech Leadership Forum

May 2019

Exploring opportunities and challenges in a changing financial services ecosystem

The financial services industry is still in the relatively early stages of a period of significant change. New business models, technologies, and competitors are changing the landscape for incumbents and fintech challengers alike. Increasingly, rather than trying to be all things to all customers, even the largest banks see themselves as part of a growing ecosystem. Recent moves by some large banks have sparked others to consider new approaches: *"I think Marcus was a catalyst. Goldman is going big and hard to digitize credit,"* according to one executive. Although they initially viewed fintechs as a competitive threat, bankers are increasingly eager to speak with them as sources for help in migrating away from legacy systems and identifying new models. Fintechs, meanwhile, recognize that they remain reliant on the banking system and see banks as important customers and sources of capital. On April 8th, 2019, in San Francisco, fintech CEOs, bank executives, and regulators convened for the Banking and Fintech Leadership Forum at LendIt Fintech USA to discuss the evolving financial services ecosystem and opportunities and practical challenges in improving collaboration among banks and fintechs. The Forum was sponsored by White & Case.

What does the next phase of fintech and financial services look like?

Fintech has seen significant growth, especially since the financial crisis, and particularly in lending. In fact, fintech now accounts for close to a third of all consumer lending in the United States.[1] A handful of intrepid fintechs are still in the early stages of exploring new models, materially expanding product offerings, or considering applying for banking licenses. As banks and fintechs consider growth and partnership opportunities, participants discussed what the next phase of growth in financial services might look like.

External factors are changing the market for financial services

The financial services space continues to experience significant disruption. While fintechs have clearly contributed to this disruption, participants identified several exogenous factors that could further influence bank and fintech business models:

- **Customer loyalty is declining, but brands still matter.** Everyone wants deeper customer relationships. Fintechs have made inroads into bank revenue streams by providing an alternative and often superior experience to bank customers. A bank director observed, *"The millennials affiliate more with Venmo. They trust in Venmo more than a bank. Their relationship with a bank is very minimal."* As consumer preferences adapt, fintechs may find themselves equally at risk, as loyalty to a few core financial services providers is replaced by marketplaces and easy access to products from many different providers; customer loyalty may only go as far as the customers' latest online search. A fintech executive said, *"No one owns the customer today. They just go to Google or to the Google equivalent to search for the best product and they are indifferent as to who provides it."* Some refer to this as "the great unbundling."

A fintech executive suggested, however, that *"some banks are affinity brands, like USAA. It is hard for me to see a fintech achieve that and come in and own the customer relationship across a range of products and services*." Even after the financial crisis and ongoing conduct issues, brand recognition still favors large banks. A fintech executive observed, *"We drop thousands and thousands of pieces of direct mail. The only thing we've done which makes a difference is by putting a bank name on the paper. That bank name adds so much trust to the offer."* Interestingly, a participant noted that a bank's marketing materials referencing a partnership with a fintech also increased response rates.

- **Big tech platforms are pushing further into financial services.** "Techfins" may prove to be the biggest competitive challenge to both banks and fintechs over time. A bank executive said, *"The one thing that people haven't talked about today, which will be interesting, is Amazon. They've been very careful here, but in other markets they are moving much more aggressively,"* for example launching peer-to-peer payments in India. A fintech executive agreed stating, *"When I look at everything that Amazon has done, if I were them, I would say 'Why not?'"*
- **Global cross-pollination of technologies and business models.** Many of the most innovative developments in financial services are taking place in emerging markets where literally billions of people are gaining access to financial services for the first time, payments are being completely digitized, and new players are surpassing established providers. A bank executive observed, *"Here in the United States, we have 10 apps to do 10 different things, but in China they really just have one or two that do all of them, including financial services. And none of them are banks."* While participants debated whether business models implemented in China could be replicable in Western markets, a senior bank leader suggested, *"China is a good place to start,"* if you want a view of the future.

New models are emerging

The financial services ecosystem is clearly changing. How it evolves, and the roles that emerging and larger fintechs will play relative to established incumbents, remains unclear. A few key variables could determine the outcome: *"I see two things that banks have which fintechs don't:*

capital and customers. Fintechs have two things that banks don't: an ability to acquire customers at a low cost and technologies. We don't have legacy and have built our platforms from the base up … The challenge for us is regulation and the access to low cost capital. If the fintechs get access to that before banks can figure out tech and customer acquisition, that's the ultimate set of conditions for fintechs to take more share," according to one fintech CEO. Participants identified several possible, potentially overlapping scenarios:

- **Diversifying fintech products.** While many are diversifying their product mix, many fintechs see a broader opportunity in leveraging their strengths. Some are offering platform as a service (PaaS) or providing white label or co-branded services to financial institutions. Others are partnering not just with financial institutions, but with corporates to expand employee financial and benefits services. Most see those offerings a source of growth in the future.
- **Automating wealth management.** Fintechs have left their mark in lending, payments, and retail banking. A bank executive saw wealth management as the next area prime for disruption, *"People are pretty convinced that wealth advisors provide no value. Robo advising will take over the whole thing. It will be mostly robo and you'll pay for advice."* Many commenters have referred to this as the "democratization of wealth management."
- **Expanding service to the underserved.** The rapid advance of technology may create opportunities for traditional players to leverage their data resources to deepen relationships with existing customers. De-risking by large banks post crisis created an opportunity for fintechs, many of which have focused on customers not being well-served by incumbents—e.g. subprime borrowers, or in specific products like student lending—with a focus on improving credit access to more customer segments. A fintech executive observed, *"The core opportunity is serving the underserved. The banks tend to focus upon people with credit scores of 700 to 750. And yet the typical person who opens a bank account may well have a credit score in the 400s. The banks are doing very little with many of the people who open checking accounts with them."*
- **Changing mix of customer-facing and utility functions.** A fintech executive predicted, *"We see the evolving business models will be those focused on relationships and those that are more like utilities. Particularly with the regional banks, there will be a couple of major players and nothing else."* Under this scenario, a financial services provider either owns the customer relationship or provides the pipes anonymously to deliver services to that customer, or acts as the product manufacturer, disintermediated from the customer. A senior bank leader acknowledged this possibility for some banks saying, *"I do think there's a real risk that banking becomes plumbing. If you ask my kids, they are not particularly aware of the furnace down in the basement—they would say the Nest [thermostat] on the wall is how we get heat in the house. The furnace, or what kind of furnace, is of no interest. It comes from a vendor*

with no brand value to the consumer." This could be driven by new business models from a major financial services provider that focus on providing a more complete set of financial well-being tools and products via a single app, what one participant called *"relationship banking on steroids."* Such a model would allow one provider to centralize the primary financial services relationship, bringing in products and services from third parties via APIs.

- **Fintechs become banks to further expand product offerings and access capital.** Participants saw near-term challenges for monoline product and service providers. A director observed, *"Monoliners—we've seen chapters like this before. With the financial crisis, the monoliners had to transition into banks or go out of business."* One possible solution to the monoline issue confronting some fintechs would be to seek a bank charter. Not all, however, are convinced that is the right approach. A fintech executive remarked, *"Those who want to be a bank have never worked at a bank. A lot of them want to have a charter. They just don't understand how difficult deposit products are."* The ability to access deposits and inexpensive sources of funding is appealing, but the costs, particularly related to compliance, make bank charters an expensive proposition. As one fintech CEO noted, *"If banks were not heavily regulated, we wouldn't exist."*

- **Banks and fintechs materially expand partnerships.** Given the perceived limited options for fintechs to grow, some see a definitive strategic decision ahead. A fintech CEO remarked, *"Everyone comes to a choice where you either pursue the charter or find a way to partner with banks. I am not a believer in a middle road."* The decision to partner seems obvious to some fintech leaders. One fintech CEO said, *"Within the last couple of years, the banks have committed to evolution and are investing in mobile and the customer experience. You then look at the banks and their sheer size and scale and it seems that if banks embrace transformation, they will win. So, we'd love to help."* Another fintech executive agreed, *"It is up to us to broker partnerships to build out what we don't have."*

  One participant noted partnering does not have to be limited to narrow self-interest for some banks: *"It is not always about the bank as the winner. It's also how do we help an industry that is lagging to benefit from the digital revolution?"*

How can partnerships be effective?

Regardless of how the ecosystem develops, meeting participants expect more partnering and collaboration among banks and fintechs and see mutual benefit in expanding partnerships. They discussed what makes these partnerships attractive and how they can be most effective.

The banks' perspective

Most banks are investing in innovation and transforming their organizations via technology. With so much activity in fintech, it can be difficult to cut through the noise and *"curate internally and then source accordingly."* Participants said they look for fintechs to partner with that:

- **Are at the right stage of growth and development.** A bank executive said, *"We look for companies that have found product/market fit. We are not nimble enough to stay with a start-up through the different stages as they figure it out."*
- **Can help the bank expand or improve product offerings.** Large banks offer a wide array of products and services to customers. Therefore, a partnership's objective must provide new or different ways of serving customers, the ability to offer them something new, to be valuable. A bank executive said, *"The question is, what are we going to do differently for our clients? What needs are not being served today?"* Another bank participant stated, *"Enhancing the product set has to be number one."*
- **Are adaptable**. A bank executive said they ask, *"Can we integrate the fintech offering with how the existing offering is set up?"* This is not without its challenges. Legacy systems remain an obstacle: *"It is amazing the extent to which US banks are anchored by 1960s technology. They carry this chain around with them,"* noted an executive.
- **Have done their homework.** The bankers recommended fintech leaders get as much information as possible in advance to qualify potential bank partners. One said they consider, *"Do they understand our strategy and priorities? Do they understand budgets? Do they know who the real leader is?"* Another advised, *"Understand the organization's focus. Our innovation group is focused on crypto right now. They are not going to partner with a lender."* Another said they should ask direct and specific questions up front, such as, *"'Do you work with companies that host everything on AWS or Azure?' Because we won't."*

  Bank approaches to innovation and partnerships vary: *"We have gone back and forth on whether we should centralize this with an innovation group or spread it out among the businesses, etc. There really is no silver bullet, so the fintechs just need to figure it out for each bank. So, be really focused and learn from those that have done it before. And find an internal person who can guide you."*

The fintech perspective

For their part, fintech leaders offered perspectives on what to look for when considering a partnership with a bank. One summarized: *"1. Senior: you need C-suite level or a key lieutenant to the CEO, 2. Serious: they have to know what they are talking about and have done their* *homework, 3. Real: proof points that the senior person who is serious can make something happen."* Participants elaborated on these and related things to consider:

- **Addressing a real need.** A participant said fintech leaders should consider, *"Is there a real business need or is this just a way for the bank to talk to cool startups?"* Some will take meetings with fintechs interested in partnering with no real intention of doing so, simply to stay close to what is happening in the space. Although there was some equivocation on this point from fintech and bank executives alike, one executive stated, *"Never do a free proof of concept; it means the bank do not really value it."*
- **Senior leaders' support.** Fintechs, especially those in the earlier stages of development looking for growth, operate on a different time scale than large banks and don't have the luxury of waiting. A participant emphasized the importance, therefore, of a senior sponsor within the bank, saying, *"There are always people who are senior enough, have enough personal capital, that they can cut through the bureaucracy and get things past all the committees."*
- **Serious about a real partnership.** *"I don't like 'paper partnerships,' which are more about PR, putting out a press release, but they don't really do anything."* A fintech CEO said, *"We have seen examples where we spend 2-3 years and then no one cares about it."* A bank executive admitted, *"We should say 'no' quickly if there is not something there. We don't naturally do that in big companies."*
- **Urgency.** *"A healthy degree of paranoia is good for us. We don't want a complacent bank,"* said a fintech executive. Sometimes, that urgency comes from a board that recognizes the competitive threat from new entrants and the need to respond, thereby freeing up capital and focusing management attention on new initiatives, including partnerships.

Overcoming differences to expand partnerships

In response to a reference to a commentator who said, "Banks are from Mars, fintechs are from Venus," to describe how different they are, a participant observed, *"I would say banks are more like Jupiter—they are very large, a year takes a very long time, and they have these rings around them that make them feel special, but don't really do anything."* Working together presents some practical challenges. While partnerships are becoming more common, they are generally limited in scope. Prior to the meeting, a fintech executive said, *"We have a number of partnership arrangements with banks. But I don't just want to work with three or four banks, I want to work with twenty."* In the meeting, several participants suggested there could be a lot of fast followers as partnerships get traction: *"There is a little bit of lemming mentality among banks, especially regional banks that may not be able to invest as much in developing these things themselves. The market is simple enough that if you can provide a service it to one bank, five more will follow."*

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There is clearly interest and motivation among both banks and fintechs to explore more partnerships and expand collaboration. Identifying compatible partners and experimenting will lead to greater adoption as financial institutions large and small adapt to a changing financial services ecosystem.

Appendix: participants

On April 8, 2019 in San Francisco, Tapestry and LendIt hosted the Banking and FinTech Leadership Forum. Discussion focused on exploring opportunities and challenges, including partnership opportunities, in a changing financial services ecosystem. Insights gathered in calls in preparation for and during the meeting informed this Summary of Themes. Unattributed quotes from these discussions appear throughout.

The following individuals participated in these discussions:

- EJ Achtner, Head, Digital Banking & Strategic Change, US Commercial Bank
- Era Anagnosti, Partner, White & Case
- Dennis Andrade, Partner, Tapestry Networks
- Noah Breslow, CEO, OnDeck
- Bo Brustkern, Co-Founder & CEO, LendIt FinTech
- Jeff Cady, Managing Director and Head, North American Financial Institutions Group for Corporate and Investment Banking, Citigroup
- Nanci Caldwell, Non-Executive Director, CIBC
- Dee Choubey, CEO, MoneyLion
- Vanessa Colella, Chief Innovation Officer, Citigroup and Head, Citi Ventures
- Mark Cuthbert, Chief Strategy Officer, USAA
- Mark Elbaum, CFO, Marlette Funding
- John Finley, Head of Innovation & Customer Journeys, Bank of the West
- Dave Girouard, CEO, Upstart
- Al Goldstein, CEO, Avant
- Josh Guharoy, Head, Open Innovation, Bank of the West
- Tom Killalea, Non-Executive Director, Capital One
- David Kimball, CEO, Prosper
- David Klein, CEO, CommonBond
- Jeffrey Meiler, CEO, Marlette Funding
- Douglas Merrill, CEO, ZestFinance
- Tom Mildenhall, Global Head, Technology Business Development, Bank of America
- Tucker Nielsen, Principal, Tapestry Networks
- Henry Pinnell, Director, Barclays Investment Bank
- Jamie Ramenofsky, Managing Director, Silicon Valley Bank
- Ken Rees, CEO, Elevate
- Peter Renton, Founder & CEO, Lend Academy
- Paul Saltzman, Partner, White & Case
- Scott Sanborn, CEO, LendingClub
- Manolo Sanchez, Former CEO, BBVA Compass, Non-Executive Director, OnDeck, Spring Labs, Fannie Mae

About LendIt Fintech

LendIt Fintech held its inaugural event in 2013 in New York and has since grown to become the largest lending and fintech event of its kind in three markets: the United States, Europe and China. Thousands of attendees join fintech executives, bankers, and investors to learn directly from senior executives about key trends shaping the financial services industry.

About Tapestry Networks

Tapestry Networks is a privately-held professional services firm which operates networks, working groups, and research workstreams for senior leaders from many of the largest corporations and institutions in the world. Tapestry events create an environment where leaders—directors, senior executives, regulators, and policymakers—learn from one another, explore new ideas, and collaborate to solve complex problems.

Endnotes

[1] John Detrixhe, "Americans Are Splurging on Personal Loans Thanks to Fintech Startups," *Quartz,* July 24, 2018.