Fintech: Friend or Foe to Banks?

Uneasy Truce Forms as FIs Partner with Fintechs


Steve Schnall


Noor Menai


Stephen Sheinbaum

BY STEVE VIUKER

Fins are back in style. Not the Cadillac fins from the 1950s – we're talking about financial technology, better known as fintech. According to Fintech Weekly (yes, there is a publication and website devoted to the sector) fintech aims to provide financial services by making use of software and modern technology.

And the traditional financial industry is taking note – a recent panel of the New York Society of Security Analysts was devoted to fintech.

"Five years ago, venture capital totaled $5 billion in fintech. In the last two years, it has reached $20 billion globally," Justin Brownhill, managing partner of SenaHill Partners LP, said at the panel. "The breakdown is divided equally between Silicon Valley, New York City, Europe and the rest of the world. There have been fintech startups in the past few years that haven't performed particularly well – On Deck, Lending Club and Square to name three. I believe these are early-stage hiccups. Financial services is a one trillion dollar industry; fintech will soon be the same."

"Banks should explore fintech, because it will affect each institution and their small business services differently," said Stephen Sheinbaum, founder of Bizfi, an aggregation marketplace that offers many kinds of alternative funding. (Bizfi has originated in excess of $2 billion in funding to more than 35,000 small businesses.)

"For some, partnering with fintech will be an opportunity to quickly and easily improve loan application and loan servicing technology without diverting resources from compliance and other institution-wide programs," said Sheinbaum. "For others, partnering with fintech will be an opportunity to provide funding services to small businesses that cannot be profitably served by the bank itself while retaining the small business as a customer for other products and services."

Fintech provides new possibilities "that banks should seek to embrace and collaborate on," said Alex Baydin, CEO of PerformLine. "Fintech has provided consumers with new ways to take out loans and conduct online banking. In our increasingly consumer-centric environment, banks would benefit from learning about fintechs' consumer banking solutions and even working together to ensure consumers have access to banking options."

Indeed, Fifth Third Bank is partnering with VC firm QED Investors to bring new products and services to its banking customers. The firm will advise the Ohio-based bank and support its NorthStar strategy to "enhance offerings through technology."

Tim Spence, executive vice president and chief strategy officer for Fifth Third Bank, said the partnership "should enable us to identify new, high-potential technologies to complement our internal R&D and innovation efforts." (It should be noted that if an entity owns 25 percent of a bank, they are bank holding company and all the other assets are subjected to banking regulations.)

Another advocate of the partnership business model is Noor Menal, president and CEO of CTBC Bank, who spoke at a recent Marcus Evans fintech event. He told *Banking New York* that "banks are rarely early adapters, and not only because of the sum cost. Fintech will be an addition to the channels they have, or it might become the core product of the business model. Fintech firms are well aware of the regulation factors which is why many are partnering with banks. In Britain, there has been a pause in fintech investment in part due to Brexit. But Britain set up incubators for small fintech firms and helped them navigate through the waters."

There is a hope in the financial services sector that President Donald Trump will ease the regulatory burden.

"With Trump in office, there is a change in the tenor of regulation," said Divya Narendra, CEO and cofounder of SumZero. "Banks have benefited after the election in ways no other industry has. Within six months to a year, we will see what regulatory turbulence happens, New York will be affected more than any city. Some of those will be cost-focused – how reducing regulation can save money in terms of legal and compliance."

If deregulation at the federal level is to occur, it will likely be offset by increased regulation at the state level, said Baydin.

"Banks will need to remain vigilant about their consumer-facing actions and ensure they are not deceptive, unfair or abusive," he said. "Previous enforcement actions by the CFPB and FTC will serve as a guide for state attorneys as they potentially take more responsibility for noncompliance in the banking industry."

There are three types of innovation in fintech, Anna Garcia, a partner with Runway Venture Partners, said at the NYSSA event, and the first one, product innovation, has been harmed by recent regulation. The financial services industry has historically been good at product innovation, she said, "but I believe regulation has put much of it on the back burner. In the past few years, banks have had to spend their resources on legal and compliance. That doesn't excite venture capital."

Separately, Steven Schnall, chairman and CEO of Quontic Bank, pointed out an evolution "where fintech is carving out a significant place in the market."

"Many fintech firms have partnered with banks on a quasi 'rent a charter' scenario because of the nuances surrounding state by state licensing," he said. "Banks are accessing this whole universe. The need for brick and mortar branches is waning and the need for Millennials to have access to financial products online is increasing."

Charles Wendel, president of Financial Institutions Consulting, pointed to the positives of alternative finance companies. "They bring technology that can allow a bank to expand its customer base and lower its cost," he said. "Many alternative finance firms are looking to the banks as partners, because the banks can originate loan volume and the alt finance firms can provide insight that many banks don't have available." ■

Brexit Wrecks It for UK Fintech Investment

Brexit has had a chilling effect on fintech investment, concludes an article in Banking Technology. Uncertainty over Brexit has created a 33.7 percent decrease in UK venture capital (VC) investment for fintech firms, according to research by Innovate Finance.

Investment was down to $783 million – less than two-thirds of 2015's investment of $1.2 billion. Lawrence Wintermeyer, CEO of Innovate Finance, says the UK's fall is "largely attributed to the uncertainty of Brexit and geopolitical and macroeconomic factors." Wintermeyer adds, "The loss of passporting rights will hit fintech payments firms if special provisions to the single market are not negotiated upon leaving the union. However, maintaining and further improving access to global fintech talent has superseded passporting across the fintech community's post-Brexit priorities."

The UK has retained its global ranking in third place, behind China (first place) and the U.S. According to Innovate Finance, 29 percent of the UK VC investment in 2016 was into alternative lending and financing, followed by challenger banks (20 percent), wealth management (10 percent) and money transfer and FX (10 percent).

Overall global VC investment for fintech increased by 10.9 percent to $17.4 billion in 2016 with 1,436 deals. This level of funding surpassed the 2015 total of $15.6 billion.

China outpaced the U.S for the first time in deal value at $7.7 billion while U.S. investment decreased in 2016 by 12.7 percent to $6.2 billion, despite being the global leader in deal volume at 650 deals.

Fintechs to Receive Charters from OCC

The Office of the Comptroller of the Currency will start granting limited-purpose bank charters to fintech companies. Fintech firms had sought such a charter because they did not want to register in multiple states and face different laws and restrictions in each.

A federal charter for fintech firms would largely allow them to comply with a single set of national standards – and gives them a single agency to apply to when seeking a license. State regulators have warned that a federal charter is unnecessary. Some within the banking industry fear fintech firms will have now have the advantages of a bank without their obligations.

"Currently the state regulators have the authority. There had not been a federal charter available for these types of companies," Andrew Wein, who specializes in regulatory compliance and litigation for Greenberg Traurig, told *Banking New York*. "Each state has its owns rules and licensing requirements [and] the state regulators have a lot of authority over these entities. And the OCC charter is not something that doesn't come with its own cost. But if you're an entity that wants to do a national business without adjusting your business model for every individual requirement in a state, a national charter would be appealing."

Fintechs Guard Little-Known Dodd-Frank Measure

Fintech startups are preparing to fight for a little-known provision in the Dodd-Frank Act that lets them mine customers' bank accounts for data that facilitate use of investment apps and other third-party banking tools. Online investment manager Betterment and other fintechs formed the Consumer Financial Data Rights group in January to promote consumer choice and access to financial data.