April 2021

BANKING-AS-A-SERVICE:
NAVIGATING A NEW FRONTIER

CCG | Insights

TABLE OF CONTENTS

FOREWORD

"Every company will be a fintech company." That phrase traces its roots back to a presentation given by Angela Strange in November 2019. Since then, many different versions of this idea have been splashed around in the media, all driving home the same point that banking isn't just for banks anymore. This notion, that any brand can get into financial services, is a powerful one. But it misses a very significant point — for nonregulated companies in the US to offer financial products, they generally have to partner with an actual bank.

Banking-as-a-Service, or BaaS, centers on this kind of partnership, by which a regulated bank provides its charter to a nonregulated brand, enabling the latter to offer financial services to their customers. If this sounds like white-labeling, that's because it is. But it's also more than that — there are a slew of operational and compliance components that go into launching "bank," and the actual bank underneath needs full oversight and visibility into how those components are being managed. That's where BaaS providers come in. These technology-first facilitators help the bank to manage their BaaS operations, while working with fintechs or brands to set up all of the components they need to get to market, from their risk stack to their ledger.

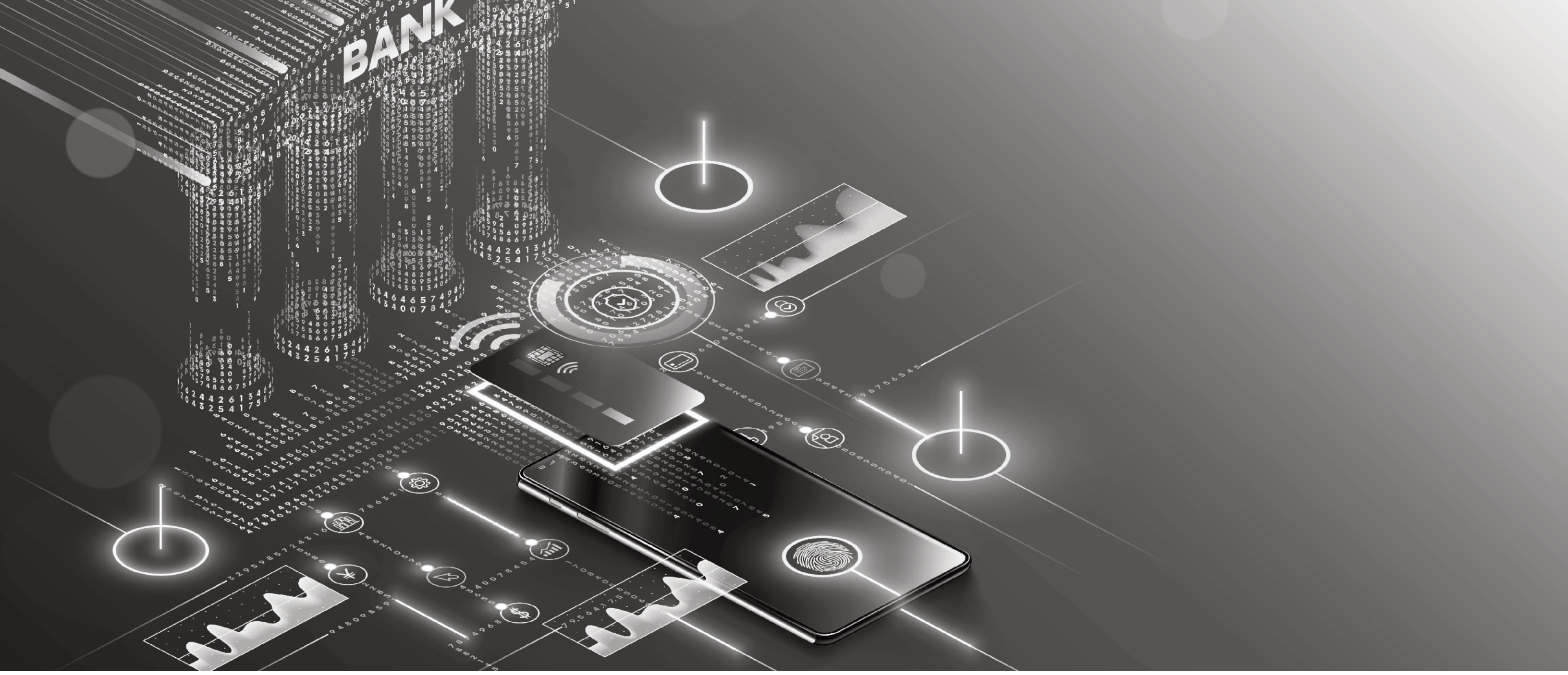
Today, most of the chatter around BaaS tends to focus on the fintech or brand partners. This makes sense, because the ability for these players to get to market with financial products is changing what banking means for consumers. For example, if I can get a bank account through Venmo (partnered with The Bancorp Bank), that fundamentally changes how I manage money that comes in from friends or family. What's often left out of the conversation, though, is what it means for the bank. How did they do it? What are the benefits and risks? And what can others do to follow suit?

This report attempts to provide banks interested in getting into BaaS with an understanding of how these partnerships work, the considerations necessary to be successful, as well as the BaaS provider landscape. There is a great deal of value in outsourcing parts of this process, but there are different options for different kinds of banks, especially when it comes to balancing offloading operations and minimizing risk. We've spent many hours in conversation with bank executives, BaaS providers, and their fintech partners to truly grasp how these relationships work. What follows is the result of that effort. We hope you enjoy it.

Kate Drew
Director of Research

Kate Drew

www.ccginsights.com



BANKING-AS-A-SERVICE:
NAVIGATING A NEW FRONTIER

There are few trends today more poised to change the face of banking in the US than Banking-as-a-Service, or BaaS. It's emerged in full force over the last couple of years as fintechs and other nonbank players increasingly began looking for ways to operate in the banking space without going through the grueling process of acquiring a charter. Enter banking institutions with those charters looking for greater distribution. BaaS is effectively a way for banks to white label their regulated banking services and deploy them through a third party that manages the front-end customer experience.

A BaaS business model allows a bank to outsource two very important elements: customer acquisition and the customer experience. Both of those areas are extremely difficult to do well in an environment that's highly competitive and driving rapidly toward a digitally advanced future. However, much of the hype around BaaS at the moment focuses on what it means for brands and how it easy it will be in the future for "anyone to become a bank." It's an important area, because the ability for brands to easily add banking services is what will eventually transform financial services as we know it. But what about from the bank perspective? If you are a bank today, how do you prepare your business to participate in this future ecosystem?

This report will explore what the BaaS model looks like from the bank perspective, what institutions need to consider to tackle BaaS successfully, and how an emerging crop of BaaS vendors is setting the standard for this new way of distribution.

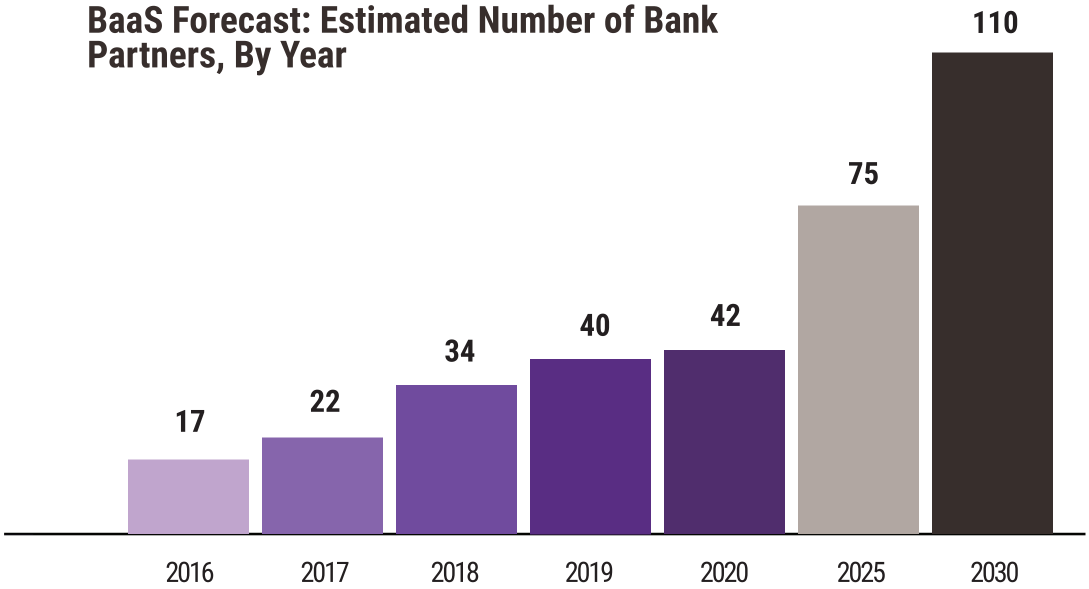
WHAT IS BAAS — AND WHY IS IT SO HOT, RIGHT NOW?

BaaS is a distribution model by which regulated banks deploy their products through nonbank brands, effectively licensing their charters. Under this scenario, the bank partner provides regulated infrastructure to a brand, often a fintech, looking to offer financial products, and, in turn, gains access to new revenue streams. Banking products provided by some of the biggest fintechs in the country are powered by bank partners: Unicorn neobank Chime, for example, is backed by a few partners including The Bancorp Bank and Stride Bank, while digital wealth manager Acorns offers a debit card powered by Lincoln Savings Bank. This allows these fintechs to provide Federal Deposit Insurance Corporation (FDIC)-insured accounts to their customers. In practice, this has generally amounted to a large For Benefit Of (FBO) account in the name of the fintech, with customer accounts held as sub-accounts underneath, though the market is now beginning to embrace full demand deposit accounts (DDAs). In addition, banks are providing other products like card issuing, payments, and lending via BaaS.

The popularity of BaaS is tied to its promise to handsomely benefit parties across the financial services spectrum: traditional banking institutions, the producers; fintechs or brands, the distributors; and customers, the users. Nonchartered brands that want to move into financial services often have the customer experience nailed but need a license to get to market; banks may struggle on customer experience but have the license and compliance expertise. Marrying these two together gives customers the experiences they are looking for under a regulatory umbrella. This synergy is putting BaaS in the spotlight and leading to deal announcements almost daily. Meanwhile, the number of partner banks has increased dramatically over the last few years, jumping from 16 in 2016 to over 40 in 2020, according to data compiled by CCG Catalyst. And that's likely going to continue to climb as more banking institutions wake up to the opportunity BaaS presents: Partner banks tend to operate at return on equity (ROE) and return on asset (ROA) levels that are two to three times above average, per Andreesen Horowitz data.[1] However, it's likely those banks that enter this market early that will reap the most gains and benefit from the most favorable agreement terms. That means it's important to have a strategy today, for the future.

1. The Partner Bank Boom, a16z

BaaS Forecast: Estimated Number of Bank Partners, By Year



Source: Figures are estimates based on press, company websites, and CCG Catalyst analysis

A key benefit to banks is in the lower customer acquisition costs the BaaS model provides. BankMobile, which is behind T-Mobile MONEY, boasts customer acquisition costs as low as $10 per new account, [2] compared with an industry average of about $300, [3] for example. Additionally, banks with under $10 billion in assets are exempt from the Durbin Amendment, which means they are not subject to a cap on interchange fees and can therefore build their BaaS models around customer swipes. As a result, BaaS is especially popular with banks that fit this bill. We're also seeing additional revenue models emerge, including pay-as-you-go and subscription options.

This probably all sounds like a no brainer from a benefit standpoint. But there are a number of considerations that need to be worked through in order to implement BaaS well. Many of the early BaaS tie-ups between banks and their partners were direct agreements that came with technological and operational hurdles, especially when the bank hadn't done any deployments before. More recently, BaaS infrastructure providers have stepped in to abstract some of the complexity in these relationships and streamline the process. These providers sit between the bank partner and the brand, handling the technology and operational issues in between. This can be a helpful option, but it requires outsourcing and a strong understanding of the landscape. There is considerable risk in white-labeling regulated products, and it's the bank's responsibility to manage that risk in the selection and oversight of its partners.

2. Megalith Financial Acquisition Corp. Press Release, August 2020
3. Efma, June 2020

The BaaS Ecosystem

DISTRIBUTORS

acorns, affirm, Aspiration, Brex, Cash App, chime, coinbase, Current, Daylight, First Blvd, GREENLIGHT, HMBradley, monzo, Revolut GLOBAL MONEY APP, Robinhood, venmo

INFRASTRUCTURE PROVIDERS

GALILEO, MARQETA, Q2, synctera, Synapse, TREASURY PRIME

PRODUCERS

The Bancorp, bank prov., Burling Bank, COASTAL COMMUNITY BANK, EVOLVE bank & trust, FIRST HORIZON, i bank, Lincoln SAVINGS BANK, MetaBank, MVB, nbkc bank, PACIFIC WESTERN BANK, Piermont Bank, RADIUS BANK, SuttonBank Old-fashioned Innovation

Note: Select logos included, US only.
Source: CCG Catalyst

Banks just beginning to explore BaaS need to examine the ecosystem around them in order to be successful. Ultimately, it's those banks that have taken a strategic approach here, and fully thought through how BaaS can complement their existing business while maintaining the proper controls that will make the most of this opportunity.

GETTING READY TO TACKLE BAAS

The first step to tackling BaaS is to determine how you are going to approach the market. There are two core paths into the BaaS ecosystem that banks can take: direct or through a BaaS provider. (Some also pursue a combination of both.) Banks that go direct manage their own BaaS relationships and operations in-house. This route gives banks greater control over their ecosystem but also requires considerable resources. Examples of institutions that have taken a direct way in are BBVA and Green Dot, as well as Cross River Bank. We will cover this approach in detail a subsequent report, while here we will focus on the ecosystem of BaaS providers.

BaaS providers are technology-first facilitators that allow the bank to outsource all or part of the process. The bank defines all of its policies and procedures for its BaaS operation, including target customers, onboarding, and risk assessment, with the BaaS provider, which then handles the day-to-day management of activity and reporting back to the bank. The bank will usually set up a single integration point to this provider, eliminating the need to integrate multiple times with many different partners. In a fully outsourced scenario, the bank manages a single relationship with the BaaS provider, which then manages all of the partner relationships on the other side. Some providers will handle everything all the way down to cardholder disputes and customer service.

This approach takes a lot of the burden off of the bank, but it also means sacrificing control, especially when it comes to relationship management. In fact, in some cases, the bank may not have any direct relationship with their fintech or third-party partners at all. Banks that take this path are likely to be those willing to trade control for help getting started, or those with experience now looking to scale beyond what they feel they can reasonably manage on their own. Additionally, in the conversations we had with these BaaS providers, most of them tended to refer to fintechs or brands as their customers. This is telling because it suggests this is the market they are serving, while their banking partners are just that, partners. Because of this, BaaS providers often do not need to partner with many banks, making the environment somewhat competitive.

Most of these providers are also newer market players, and their BaaS propositions are even more novel. Each is currently working with only a small number of banks on BaaS today. Banks that are looking to go this route will need to thoroughly evaluate the vendor risk associated with such a proposition, and whether or not it's suitable for their business. For those that decide it is, selecting the right partner and determining the right level of outsourcing for your bank will be key. These providers can do a lot to streamline the process, but the compliance burden ultimately sits with the bank, always.

THE BAAS PROVIDER LANDSCAPE

In the world of BaaS, a fintech or third-party distribution arrangement is typically called a program. The program manager in a direct relationship would be the fintech or third party. When a BaaS provider is involved, they will often take on some, or even all, of the program management activities. These activities include things like reporting and oversight, relationship management, and, in some cases, operational components like cardholder support. The level of management the BaaS provider takes on depends on the provider and the preferences of the bank.

Below, we take a look at a few notable BaaS providers in the market today. While all of these players participate in the BaaS ecosystem, their offerings and approaches differ in certain ways. As such, banks exploring this market should keep in mind that it's less about finding the winning provider and more about finding the right partner for your bank. The following is meant to provide an overview of the landscape and in no way serves as a set of recommendations by CCG Catalyst.

GALILEO

GALILEO

Galileo, a subsidiary of fintech unicorn SoFi, is known primarily for its application programming interface (API)-based payment processing platform used by big-name fintechs like Varo and Monzo. However, it's central position within the fintech tech stack has made the company well suited to morph into a full-scale BaaS provider. It currently works with about 20 issuing banks across its two core BaaS offerings:

Galileo Pro. Banks on Galileo Pro manage their own fintech or third-party relationships and leverage Galileo's platform to enable the operational components. The bank holds an FBO account for each of its programs that run on Galileo's ledgering system, and the company provides a live dashboard as well as flat files each day for reconciliation. It works with the bank to build out the reporting and policy requirements before launch. All of the vendors for things like KYC are selected by and agreed to by the bank and their fintech or third-party partner, and all activity is tracked within the platform, giving the bank full visibility for compliance oversight. In addition to debit accounts, Galileo Pro supports a range of products including secured credit and prepaid.

Galileo Instant. The company's full-service offering is called Galileo Instant and launched 10 months ago. [4] Galileo Instant allows fintech

4. Galileo News, February 2021

or brand partners to issue debit cards through Galileo, which then handles all of the reporting back to the bank as the program manager. The key difference between this offering and Galileo Pro is that bank's relationship is with Galileo, and all procedures and vendors for areas like KYC are agreed to with and managed by Galileo. "With Galileo Instant, all of the parameters are fixed, and we are laying out with the fintech or brand what all of the procedures are, who all of the partners are, as well as handling things like call center traffic and disputes," Mike Douglas, VP of strategy at Galileo explained.

Galileo Instant has seen tremendous uptake among businesses looking to offer financial products, with over 1,500 signing up since it launched. However, this service is quite new and just beginning to demonstrate where Galileo may go in the future. The company currently has only one bank partner for Galileo Instant, The Bancorp Bank. Galileo Instant is also a heavily outsourced proposition; meaning the bank is giving up quite a lot of control. Galileo Pro, meanwhile, is best suited to banks that have already identified fintechs or brands they want to work with, and are looking to get to market quickly, while streamlining reporting and compliance. The business model for Galileo Instant is a revenue-sharing agreement, while Galileo Pro is fee based. Banks on Galileo Pro have their own revenue agreement with their fintech or brand partner.

MARQETA

MARQETA

Similar to Galileo, Marqeta was a big-name in fintech long before BaaS came into the spotlight. The company built its business on its card issuing and processing capabilities, which landed it major deals with the likes of Goldman Sachs and put it on the path to an initial public offering. More recently, it's started branching into BaaS program management, with its two current bank partners, MetaBank and Sutton Bank. It's a multi-month undertaking to onboard a new bank, explained Justin Wee, head of digital banking at Marqeta, one that includes understanding all of the bank's procedures, approving vendors, and aligning with the bank's risk team. The fintech signs an agreement with Marqeta, which then determines which bank is best equipped to handle the program. Marqeta has an independent revenue arrangement with the bank, as well.

Marqeta is certainly well positioned to serve as a one-stop-shop for BaaS, but it's quite tight-lipped on its plans for this offering. The company declined to provide further specifics on this part of the business, likely because it is so new and still firming up. Many experts we spoke with believe that heavyweights like Galileo and Marqeta, with their deep experience providing elements of the fintech stack, are likely to become major winners in the BaaS infrastructure game. In fact, most say that's already happening. It will take time for some of these newer initiatives to take shape in the market, though, especially from the bank point of view.

Q2

Q2's been dancing around the BaaS space for a while, including via Cambr, a joint venture with deposit network StoneCastle that it dissolved last year. [5] It's since repositioned its offering to focus on its CorePro system. A bank can use CorePro to run a white-label business in parallel with its existing systems, and it's the same core system that Q2's fintech partners run on. This setup alleviates integration issues on the bank side, as the proposition is completely standalone from its traditional business. The company works with the bank to put in place policies and procedures in areas like AML and disclosures. The goal is to simplify all of the operational and technical components for the bank, so it can focus on the compliance elements, like Tier 2 escalations, reporting back to auditors, managing audits, and overall program oversight, Ahon Sarkar, Senior Director, Product & Strategy at Q2, told CCG Catalyst.

The company's banking clients are matched with fintech partners based on competencies. For example, a bank partner with considerable experience with white labeling and high-volume customer onboarding would likely be matched with a larger fintech partner that handles deposit accounts at scale. A bank just looking to get its feet wet might be matched with a smaller player with 10,000-50,000 users or so, perhaps more focused on savings and less on transactions, Sarkar explained. The business model is a three-way revenue split between Q2, the bank, and the fintech. And, while Q2 helps to connect and advise the parties, the bank maintains direct relationships and operational oversight over its partners' programs.

Q2's proposition is a bit different to others in the market because it includes a dedicated, real-time core that a bank can use to run its white-label business. As a result, all of the accounts are ledgered on Q2's system, all of the diligence checks are handled within the Q2 platform, all of the transactions are handled through the Q2 platform. None of

5. Finextra, May 2020

the backend processing is handled by the bank or by the third-party partner, and Q2 provides tools to simplify and automate reconciliation. That's obviously attractive in theory. It's worth pointing out, though, that the Cambr venture was only sunset in the last 12 months, so Q2's BaaS strategy is likely very much still evolving. Integration with Q2 systems takes 3-4 months for an FBO or savings product, while a DDA could take up to 6 months.

SYNAPSE

Synapse sits between its three banking partners (soon to be five) and ~150 fintech partners. It offers banks on its platform, which currently include First Horizon, Independent Bank, and Evolve Bank & Trust, the ability to issue DDA and FBO accounts as well as transaction processing and card issuance services. All of the company's fintech partners run on its technology stack, including its core, and reporting back to the bank is handled by Synapse. It also works with banks to integrate into their existing file transfer system, meaning no API connection is required. The process typically takes 30-45 days.

The first step for a new bank partner is to work with Synapse to set out all of the policies and procedures that will govern the relationship. The bank and Synapse will share sample reports and agree on formats, lay out policies for daily compliance including for KYC, sanction screenings, AML monitoring, unusual activity, and daily ledger reporting, as well as work through nuances like how interest accrual will be handled and when a credit or debit will post to the general ledger, explained Sankaet Pathak, Synapse CEO.

Once all of these procedures are set out with Synapse, they are used for every third-party partner onboarded to that bank, standardizing daily compliance and program oversight. All of the controls flow through the platform; Synapse's role is to maintain those controls, while the bank's role is to maintain oversight on Synapse. Like with other full-service offerings, that means the bank is outsourcing quite a lot, including oversight of its partners, which requires a high appetite for risk. That's likely to be especially true here given the company tends to target early stage fintechs, which typically have less experience overall, and manages such a large number of relationships.

Underneath the hood, Synapse is one general ledger entry at the bank, with sub-accounts that pertain to partners and their users. Each day, Synapse provides a reconciliation report that includes data on all of the transactions for each of those sub-accounts. Banks are matched with fintech partners based on capabilities, though they can also bring their own partners to the table. Revenue agreements are negotiated upfront, and those terms are applied to all fintech partners for the bank.

SYNCTERA

Synctera's proposition is unique in that it's specifically designed for banks, and in particular for community banks that have never done this before. It's also extremely new; the company is currently working with just one bank and one fintech, Coastal Community Bank and One Finance, respectively. Synctera provides a platform that matches banks with third-party partners based on their preferences and core competencies, as well as acts as a translation, billing, reconciliation, and reporting layer in between those parties once they've entered into an agreement. It connects to the bank's existing file sharing system and provides a dashboard housing all activity happening on the platform, including matching all activity happening inside of a third-party app to policies laid out by the bank.

While Synctera will act as an advisor, providing best practices for policies and templates as well as helping banks conduct due diligence, the agreement is ultimately between the bank and the fintech or brand. Synctera has a separate revenue-sharing agreement with the bank. The platform's central role is to translate the policies that banks need to govern their relationship with a fintech into actions that can be monitored by the bank's compliance teams; it provides real-time quality control on everything the fintech does, Dominik Weisserth, head of product at Synctera, explained. For example, the platform will track each end user's onboarding journey to ensure all regulatory requirements are being hit and flag any activity that is outside of the expected parameters. The company provides a single set of market-facing APIs that all third-party partners connect to.

Synctera supports only the FBO model and provides reporting on all of the individual account activity for reconciliation purposes. All reporting and policy requirements are defined with the bank and implemented by Synctera. The fintech is responsible for complying with those policies, and the bank is responsible for oversight. The platform provides a channel for monitoring the activity in between.

TREASURY PRIME

Treasury Prime works with five bank partners across 40 fintechs. It integrates directly to the bank's core and other necessary systems in a 6-8 week process and then provides a single API to the market. The

company works with the bank to understand what products it wants to offer, which systems need to be involved and reporting requirements, as well as all of the KYC and fraud protocols that will be required, including deciding on pre-approved vendors. Each setup is specific to the bank but is delivered through Treasury Prime's API endpoint to all third-party partners. Treasury Prime also provides a dashboard with a real-time view of all information flowing through the platform. The platform is an API layer and workflow engine, which means that all of the activity happens on the bank's systems and is overseen by its compliance teams.

There are two ways third-party partners can operate: either by connecting directly to the bank's core through the API or by using the Treasury Prime ledger. Those that connect directly can originate individual accounts on the bank's core, while those on the Treasury Prime ledger will leverage an FBO account. For those doing the latter, the ledger keeps track of all transaction history for the FBO and provides connection to payment gateways. Reconciliation is only necessary for those on the alternative ledger, and all of the transaction activity is provided through the platform.

Additionally, the economic implications are different for each option. It can cost the bank more money to open many accounts versus a single FBO, which means that, for partners with small average deposit sizes, this is a more viable path. The business model includes a services component for the integration and monthly payments for the API usage by the bank's partners. Based on the bank's preference, fintechs either sign their own contract with the bank or Treasury Prime, which includes payment for API calls as well as any interchange component, of which Treasury Prime gets a cut.

Treasury Prime will act as program manager in some instances, while in others the bank will handle the program management; it depends entirely on the bank's preference. In cases where it acts as the program manager, Treasury Prime takes on everything from sourcing partners and relationship management to handling disputes and customer service. According to Remy Carole, head of business operations at

Treasury Prime, the company is seeing more interest in its program management services from both newer banks as well as those that by this point have many fintech or brand partners and are looking to scale further.

Treasury Prime's been in this space for some time, and, like Synctera, it puts more focus on its bank relationships than other providers, as evidenced by the time it takes to integrate on the backend. Similar to Synapse, it serves smaller fintechs (most of which are under the FBO model), creating some of the same risks and considerations, though it generally takes on much less from an oversight perspective.

BaaS Providers' Offerings and Partners

	PROGRAM MANAGEMENT OPTION	INTEGRATION	BUSINESS MODEL	BANK PARTNERS
GALILEO	Yes	File sharing	Fee-based, revenue share	The Bancorp et al.
MARQETA	Yes	Not disclosed	Not disclosed	MetaBank, Sutton Bank
Q2	No	None, standalone core	Revenue share	Lincoln Savings Bank, nbkc, MVB
Synapse	Yes	File sharing	SaaS, revenue share	Evolve Bank & Trust, Independent Bank, First Horizon
synctera	No	File sharing	Revenue share	Coastal Community Bank
TREASURY PRIME	Yes	Integration with core	API-based, revenue share	Piermont Bank, Radius Bank (now LendingClub), Burling Bank, BankProv, Pacific Western Bank

Source: CCG Catalyst analysis

BAAS IN PRACTICE

Understanding how these relationships work in real life is critical to charting a path forward. We asked each of the providers we talked to if they were interested in supplying a bank partner to share their perspective. Below, we profile a couple of banks' approaches to BaaS and how they work with BaaS providers to streamline the process.

NBKC BANK

nbkc bank began its BaaS journey about three years ago, and it now has around 15 fintech partners. The goal for the bank was to bring itself closer to the fintech ecosystem, while also obtaining access to low-cost deposits, explained Melissa Eggleston, chief deposit officer, EVP at nbkc. It benefits from holding its partners' deposits on its balance sheet and also collects fee income from interchange as well as things like program management and oversight. nbkc offers an FBO, savings, and DDAs currently and expects to move into other products like lending in the future.

The bank runs its current BaaS operation on Q2's CorePro, which means it is managed separately from its traditional core banking business. It also means that all of its fintech partners today need to be running on the CorePro ledger. All of the necessary reporting comes through Q2, and it's integrated with approved vendors, such as for KYC and other critical components. As a result, it's a relatively light lift for the bank to get setup with a new partner from a technical standpoint, according to Eggleston. New partners come to the bank a variety of ways including word of mouth and Q2 referrals.

nbkc does not outsource program management activities; it has a dedicated partnership team that manages all of its BaaS relationships. That team is charged with vetting partners for fit, conducting due diligence based on defined requirements for different BaaS products (the bank's FBO product does not have a card attached, for example, which means the diligence requirements are slightly less stringent), and providing compliance oversight throughout the life of the relationship. Once due diligence is complete and contracts are signed, this team holds a kickoff and works through an implementation plan. That includes the fintech making API calls in a sandbox environment, building to CorePro, and working with the bank on disclosures, wireframes, and satisfying all contractual elements. From there, the program will go into beta with friends and family before finally going live. For a debit card product, this process typically takes between 6 and 9 months.

The nbkc model centers on creating a stand-alone BaaS operation that functions as its own business unit with its own technology stack. As a result, the bank didn't have to go through any cumbersome integration work involving its existing core, and while it needs to dedicate resources to managing the operation and ensuring proper reporting, it benefits from the simplicity of not having fintech account activity sitting on two different ledgers. The bank also has a fintech committee that is responsible for oversight of the BaaS portfolio and ultimately reports up to the bank's board of directors. Q2 is a strategic and operational partner for the bank, as well as an advisor.

PIERMONT BANK

Piermont Bank is a relatively new bank; it received its charter in 2019 and operates nationally, though it is licensed in New York. The bank is primarily focused on servicing small- to medium-sized businesses, both when it comes to its traditional business as well as its BaaS proposition. On BaaS, however, it is also open to working with fintechs on the consumer side. Its initial offering includes DDAs, ACH/wires, and debit cards. In the future, it plans to expand to other products including credit. Piermont is a de novo bank, [6] and it's worked closely with regulators on its BaaS plans from the start.

Like nbkc, Piermont Bank is heavily involved in the contractual and relationship management of its BaaS proposition. The bank has a standardized list of requirements that fintech partners need to meet from a due diligence standpoint, and it's compiled a team of four executives that reviews each potential partner, explained Rodrigo Suarez, head of innovation at Piermont Bank. It works with Treasury Prime early on in these conversations, and in some cases, the BaaS provider will bring fintech partners to the bank for consideration.

The bank works with Treasury Prime to define all reporting parameters as well as on vetting and approving vendors. All of the workflows necessary to make the relationship work, from KYC to account opening, are mapped out with and implemented by Treasury Prime. Once the fintech or third-party partner has launched, the bank has a dedicated compliance team that oversees all activity flowing through the platform. The bank receives reporting from every fintech relationship, including on all transactional activity, and it compares those reports to the parameters agreed to, including in areas like KYC and AML.

6. Piermont Bank Press Release, July 2019

Piermont Bank is operating a similar model to nbkc by which it uses a BaaS provider for the technological and operational components necessary to make its partnerships work but retains all of the oversight in-house and manages its own relationships. The bank has separate revenue-sharing agreements with its fintech partners and with Treasury Prime. According to Suarez, Piermont leverages Treasury Prime as a partner on the technology side and the business side, but it believes in playing an active role, especially when it comes to compliance. Suarez also emphasized the risk that comes with fully outsourced models, saying, “Delegating compliance can be problematic. There are a lot of issues around it. We wanted the ability to monitor our relationships and own the relationship with the fintech at all stages.” As mentioned earlier, the level to which a bank delegates will depend on the bank and its risk appetite, but it’s important for institutions to understand the different options available to them. Piermont and nbkc are good examples of banks working with BaaS providers to streamline the process without giving up control entirely and retaining touchpoints where it makes sense.

The bank currently has a very active fintech pipeline and is also launching a program that works with fintechs in beta stages to quickly launch products in the marketplace. Additionally, Piermont has not ruled out adding additional BaaS providers. “Right now, all reporting comes through Treasury Prime. But, over time, that could change, Suarez said. “We may use different channels depending on what we consider makes sense.”

CHOOSING THE RIGHT PATH

Relationships between BaaS providers and banks come in many different shapes and sizes; it's not one-size-fits-all. Knowing how you want to approach the market can go a long way not only in defining your relationships, but also in selecting the right partners to begin with. For example, while banks like nbkc and Piermont would likely steer clear of those focused on full-service solutions, others may only want to consider a BaaS provider willing to take on full program management activities. It's also worth pointing out that this space is only set to get more crowded, with international players like Mambu and new entrants like Bond planning to enter the market in the near future. And, as some of the existing players get bigger, they could opt to acquire their own licenses and cut out the bank entirely, employing a model more common in Europe. [7] This is still very much a changing landscape, and those banks looking to get involved need to take time to deeply understand the dynamics before jumping in.

Most experts suggest that having a dedicated team in place to run these initiatives and take the lead on these decisions is key. That team will be instrumental in defining everything from what products the bank will offer to how they might work with a BaaS provider, and everything in between. While there are many different flavors of BaaS, and many ways to outsource, ultimately the business falls under the bank's umbrella, and there is no getting around that. Having dedicated resources and a strategy going into it is critical, especially as it's that strategy that will define who your partners are, in the middle and everywhere else.

7. Romain Dillet, Banking platform solarisBank raises $67.5 million at $360 million valuation, TechCrunch, June 2020

ABOUT US

RESULTS-ORIENTED AND CLIENT-FOCUSED

CCG Catalyst Consulting (www.ccgcatalyst.com) is a global management consulting firm specialized across financial services focused on banking and fintech. The financial services industry is in a disruptive stage. The velocity of change is accelerating. Banks & Credit Unions are consolidating with Fintech maturing. Ongoing challenges related to Open Banking, Challenger Banks, AI, Synthetic Data, Digital Experience and so much noise. There are so many strategic options that decision-makers become overwhelmed.

As a firm, we collaborate with our clients to bring market knowledge, opportunity, research, and vision. We form a relationship to guide our clients through the velocity of change that ignite the future of our industry. As a leader, we bring expertise and vision to drive strategic value to our clients and the financial services industry. As consultants we utilize a strategy driven approach with our award winning 4D™ methodology connect to strategy, innovation and provide a broad range of services in digital transformation, technology, strategy, and operations. The firm's industry experts leverage decades of experience to improve business planning, strategies related to digital experience, technology, payments, lending, retail, operations, and organization. The firm has a unique approach for contract negotiation, evaluation, implementation, and merger acquisitions.

Our clients expect us to be the trusted subject matter expert and lead them through the current and future state of business confusion.

CONTACT DETAILS

Paul Schaus
Founder & President
Chief Executive Officer
paulschaus@ccgcatalyst.com

PAUL SCHAUS is the President and Chief Executive Officer. Throughout his successful career Paul has been a banker, management consultant, strategist, thought leader and strong advocate to the financial services industry. Paul has advised clients and led major engagements globally, from community banks to global institutions on strategy, business planning, tactical performance, profitability improvement, governance and management development. He has advised banks, fintech, credit unions, and financial technology vendors on business and technology strategies.

Kate Drew
Director of Research
katedrew@ccgcatalyst.com

KATE DREW is the Director of Research at CCG Catalyst. She spearheads client-facing research projects on fintech topics including open banking, digital channels, payments, lending, blockchain, artificial intelligence, digital wealth management, and others. Her team leverages quantitative data as well as conducts field study based on desk research, conference and event findings, and interviews with prominent industry leaders at fintechs, banks, and other financial and nonfinancial institutions. Kate's approach centers on bringing voices into data and providing perspectives informed by real experience inside of financial services companies.

August 2021

BANKING-AS-A-SERVICE:
NAVIGATING A NEW FRONTIER - PART II

CCG Insights

TABLE OF CONTENTS

FOREWORD

There hasn't been a week in the last year when Banking-as-a-Service, or BaaS, hasn't come up in conversation for me. Whether it's in client discussions, internal team calls, at industry events, or even just over dinner, this trend pops up over and over again. I'm not complaining about this — it's a topic that is truly fascinating in the way it touches every part of the financial services ecosystem — traditional financial institutions, fintechs, regulators, customers. Everyone. But it's also extremely complex. So much so, that when we set out to develop a report on it, we ended up with two.

BaaS is effectively a distribution model by which a bank provides access to the financial system to a fintech or other brand, allowing that third party to offer regulated financial services products to their customers. In our first installment, Banking-as-a-Service: Navigating a New Frontier, we focused on the emerging crop of BaaS vendors enabling banks to join this fray by streamlining the technology and operational components necessary to participate. In this second report, we examine what it's like for banks who go it alone and build their own BaaS units from scratch. Packed with examples, this report digs into the particulars of building a BaaS platform, from strategic planning to technology and infrastructure to managing risk.

Getting into BaaS without help is a huge undertaking. It means deeply understanding the compliance implications, making sure your technology can support these relationships, and, of course, selecting the right partners. In sitting down to begin this research, we felt the best way to provide valuable insight into what it means to launch an initiative of this kind would be to talk to those who've done it. The earliest BaaS tie-ups were direct relationships, which means many of the banks with experience here are also those that have been around BaaS the longest. From our conversations, we were able to distill best practices and lessons learned that we hope will be helpful to anyone just starting out on this journey or exploring this concept.

It's very easy to talk about BaaS. But, as with most buzzworthy things, doing it is a whole other ballgame. What follows is for those who want to understand what it takes to get a BaaS operation in place, maintain it, and scale it. It's for those who want to move from theory to practice. I, for one, look forward to more of those conversations.

Kate Drew
Director of Research

Kate Drew

www.ccginsights.com

BANKING-AS-A-SERVICE:
NAVIGATING A NEW FRONTIER
PART II

Banking-as-a-Service (BaaS) has emerged in full force over the last couple of years as fintechs and other nonbank players increasingly looked for ways to operate in the banking space without going through the grueling process of acquiring a charter. It's effectively a way for banks to white label their regulated banking s ervices and deploy them through a third party that manages the front-end customer experience.

A BaaS business model allows a bank to outsource a two very important elements: customer acquisition and the customer experience. Both of those areas are extremely difficult to do well in an environment that's highly competitive and driving rapidly toward a digitally advanced future. However, much of the hype around BaaS at the moment focuses on what it means for brands and how it easy it will be in the future for "anyone to become a bank." In part one of this report, [1] we took a look at what the BaaS model looks like from the bank perspective overall and how an emerging crop of BaaS vendors is setting the standard for this new way of distribution. In this second installment, we will focus on banks that have decided to go direct, building their own BaaS platforms.

1. Banking-as-a-Service: Navigating a New Frontier, CCG Catalyst, April 2021

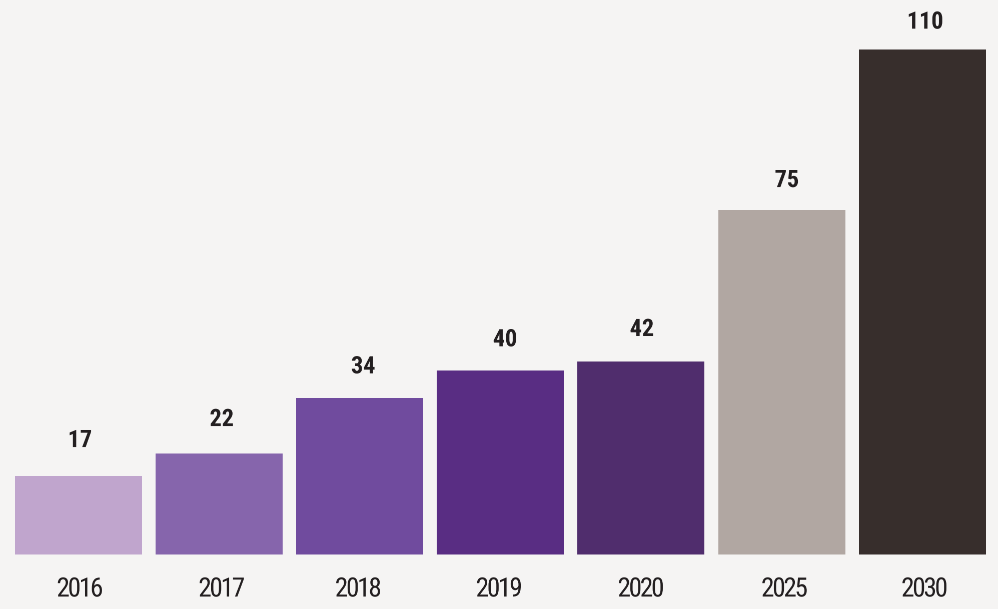
Banks that go direct manage their own BaaS relationships and operations in-house, rather than using a BaaS provider. This route gives banks greater control over their ecosystem but also requires considerable resources. Examples of institutions that have taken a direct route are BBVA and Green Dot, as well as Avidia Bank, Cross River Bank, and Metropolitan Commercial Bank, which are profiled in this report.

WHAT IS BAAS — AND WHY IS IT SO HOT, RIGHT NOW?

BaaS is a distribution model by which regulated banks deploy their products through nonbank brands, effectively licensing their charters. Under this scenario, the bank partner provides regulated infrastructure to a brand, often a fintech, looking to offer financial products, and, in turn, gains access to new revenue streams. Banking products provided by some of the biggest fintechs in the country are powered by bank partners: Unicorn neobank Chime, for example, is backed by a few partners including The Bancorp Bank and Stride Bank, while digital wealth manager Acorns offers a debit card powered by Lincoln Savings Bank. This allows these fintechs to provide Federal Deposit Insurance Corporation (FDIC)-insured accounts to their customers. In practice, this has generally amounted to a large For Benefit Of (FBO) account in the name of the fintech, with customer accounts held as sub-accounts underneath, though the market is now beginning to embrace full demand deposit accounts (DDAs). In addition, banks are providing other products like card issuing, payments, and lending via BaaS.

The popularity of BaaS is tied to its promise to handsomely benefit parties across the financial services spectrum: traditional banking institutions, the producers; fintechs or brands, the distributors; and customers, the users. Nonchartered brands that want to move into financial services often have the customer experience nailed but need a license to get to market; banks may struggle on customer experience but have the license and compliance expertise. Marrying these two together gives customers the experiences they are looking for under a regulatory umbrella. This synergy is putting BaaS in the spotlight and leading to deal announcements almost daily. Meanwhile, the number of partner banks has increased dramatically over the last few years, jumping from 16 in 2016 to over 40 in 2020, according to data compiled by CCG Catalyst. And that's likely going to continue to climb as more banking institutions wake up to the opportunity BaaS presents: Partner banks tend to operate at return on equity (ROE) and return on asset (ROA) levels that are two to three times above average, per Andreesen Horowitz data. [2] However, it's likely those banks that enter this market early that will reap the most gains and benefit from the most favorable agreement terms. That means it's important to have a strategy today, for the future.

BaaS Forecast: Estimated Number of Bank Partners, By Year



Source: Figures are estimates based on press, company websites, and CCG Catalyst analysis

A key benefit to banks is in the lower customer acquisition costs the BaaS model provides. BankMobile, the Customers Bank subsidiary behind T-Mobile MONEY, boasts customer acquisition costs as low as $10 per new account, [3] compared with an industry average of about $300, [4] for example. Additionally, banks with under $10 billion in assets are exempt from the Durbin Amendment, which means they are not subject to a cap on interchange fees and can therefore build their BaaS models around transactions. As a result, BaaS is especially popular with banks that fit this bill. We're also seeing additional revenue models emerge, including pay-as-you-go and subscription options.

While the opportunity here is quite clear, there are a number of considerations that need to be worked through in order to implement BaaS well, especially when employing a direct model. Many early BaaS tie-ups were direct agreements that came with technological

2. The Partner Bank Boom, a16z
3. Megalith Financial Acquisition Corp. Press Release, August 2020
4. Efma, June 2020

and operational hurdles. Banks today can learn lessons from those partnerships and avoid some of the pitfalls that plagued first-movers in this space, while also building on those foundations. In this report, we attempt to shed light on those lessons and share best practices for banks just beginning to explore this area.

TACKLING BAAS: THE DIRECT ROUTE

Tackling BaaS without help is a mammoth undertaking. It means navigating compliance and operational hurdles on your own, as well as ensuring that your infrastructure is prepared to handle not only the integrations necessary to run a BaaS operation but also the high volumes of activity that come with it. Based on discussions with industry experts and banks that have successfully chartered these waters, we have distilled three key areas that those looking to build their own BaaS platforms need to consider.

STRATEGY AND PLANNING

BaaS is not a one-size-fits-all proposition. Determining which products you want to offer through third-party channels, and what you want out of it will be key. For example, if an organization is looking to attract more deposits, they will come at the market from an entirely different angle compared with those looking to power lending platforms.

On the deposit side, in particular, there are a couple of options for how to structure the bank's relationships with those who will provide the front end to consumers. This is extremely important because these different options have very different implications for the bank that span across operations, compliance, and the business model.

There are three main routes a bank can take when helping a client launch accounts:

The FBO model. The FBO model is the most common BaaS model out there today. Under this model, the bank isn't opening customer accounts directly on its core. Instead, it opens a single FBO account in the fintech's (or other brand's) name. That account holds pooled funds from all of the accounts of the nonbank client's end customers. This option has a couple of key benefits. First, it is generally cheaper for the bank to open an FBO than many individual accounts, a consideration especially for clients with low average deposit sizes. Additionally, the

technological burden is much lower, as the bank does not need to be able to facilitate access to core capabilities like account opening. However, the difficulty with this approach is that it requires a huge lift on reconciliation. All of the transactions under the FBO need to be reconciled for each client. This can be a cumbersome process, and failing to do it properly has compliance implications. Additionally, because the bank is not originating individual accounts, it doesn't hold a direct relationship with the end customers; the client relationship pertains to the third party it is banking under the BaaS agreement.

Full DDAs. Banks that offer full DDA accounts through their clients are opening individual accounts for end customers. This means that, instead of having one client account for each fintech or other brand sitting on the core, it has many accounts that are ultimately being serviced by a third party. As a result, the bank can offer a more complete BaaS proposition to the market, as it takes on the account opening and core processing elements. It also owns the customer accounts in this scenario, while, as mentioned, on an FBO model, the third-party provider maintains control over those relationships. This approach requires the bank to invest more in its technology infrastructure (see below), as it must be able to provide its clients with easily consumable APIs to perform necessary functions. However, it does alleviate the reconciliation burden associated with the FBO model.

A Hybrid Approach. Some banks we talked to offer both models. These banks tend to be those that have been around the BaaS market for a long time and want to provide options for their clients. For example, some clients may prefer an FBO approach because it ultimately allows for more control over the customer relationship, while others may be looking for a more pureplay BaaS option that equips end customers with individual accounts titled in their names. For those looking to compete in different areas and pull in different kinds of clients, a hybrid model can make a lot of sense.

Regardless of which path you end up taking, most experts say that getting the right team in place first to do the leg work on these strategic decisions is key. That dedicated team can then serve as the main point of contact down the line on the bank side of the house, ultimately owning the BaaS business and all of the relationships underneath it.

TECHNOLOGY AND INFRASTRUCTURE

It's impossible to do BaaS without the ability to integrate with third parties. As we discussed in our recent report, Open Banking | Is the U.S. Ready?, [5] that typically relies on the ability to deliver data and functionality through application programming interfaces (APIs). In direct BaaS setups, this is extremely important, as partner banks need to be able to give fintechs and/or other nonbank clients access to the necessary systems and functions required to power their products and services.

As mentioned, the biggest technology lift will be on banks that want to provide full DDAs. That's because, in order to equip a third party with the ability to open and manage individual accounts, the bank needs to enable a whole host of capabilities, including account opening, inquiries, transfers, and access to account data, among other things. That requires the bank to take a truly API-first approach to its infrastructure, ensuring that its clients can easily access any function they might need. This, of course, is much easier said than done, largely because many institutions are on older core systems that weren't built with ease of integration in mind.

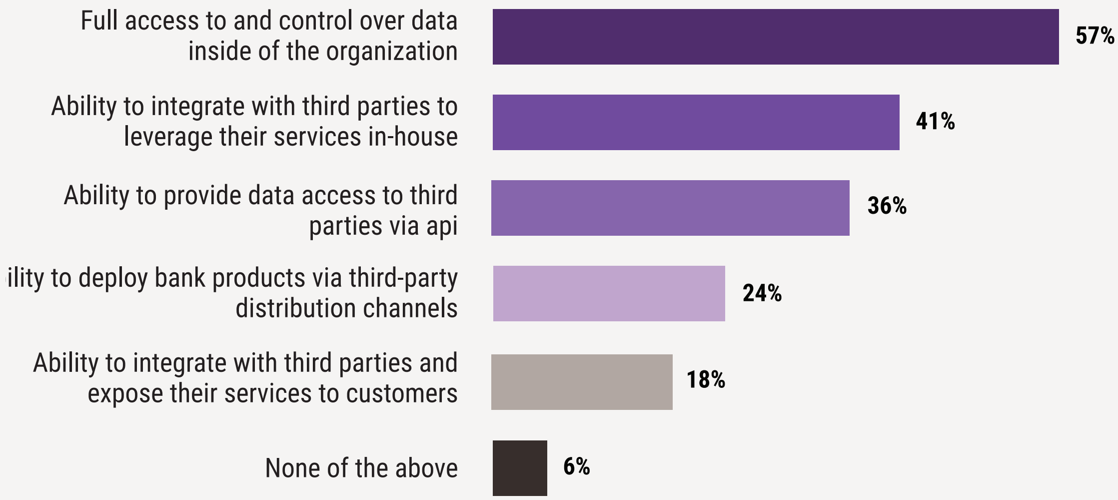
Most institutions we talked to are getting around this by exposing APIs via their core system provider and then building an API layer on top to improve useability for clients. Additionally, while the technological burden is lower for those leveraging an FBO model, as there are fewer integration points to consider, it isn't nonexistent. The bank will still need to provide access to certain systems — for example, to give clients the ability to track balances through online banking. As a result, having some sort of API strategy is an absolute must when building a BaaS unit, regardless of your approach.

Companies that provide technology that can be used to build an API or service orchestration layer in-house include MuleSoft, IBM, and Boomi. Additionally, open platform providers like Mambu and Technisys allow banks to implement these capabilities via a managed service.

5. Open Banking | Is the U.S. Ready?, CCG Catalyst, February 2021

API Capabilities Achieved at US Banks

Which of the following capabilities has your institution achieved through APIs? (Select all that apply.)



Source: CCG Catalyst's 2021 US Banking Study

POLICIES, PROCEDURES, AND RISK

There's no area more important to doing BaaS well than compliance. Every single bank we talked to put this at the top of the list, not only because they need to be sure to stay on the right side of regulators but also because compliance is part of the service they provide to clients. Fintechs and other nonbank clients rely on their bank partners to bring their compliance expertise to the relationship; it's an important part of the deal.

Doing this well requires building an oversight function to manage third-party relationships, starting with due diligence and pulling all the way through to ongoing oversight. This generally requires allocating dedicated compliance resources to the BaaS operation that are either embedded in or work closely with the team running the unit. The banks we talked to have very stringent processes for how they determine which clients to take on, in some cases, even rising to the level of conducting the same or similar assessments as they would for a critical vendor. Ongoing oversight typically pertains to monitoring reporting, marketing materials, as well as regular business reviews and audits, sometimes by an outside party.

Additionally, before entering into any relationship, a bank should consider mapping out all of the policies and procedures that will govern its agreements. For example, it might lay out how customers will be onboarded, know-your-customer (KYC) and anti-money-laundering (AML) standards, as well as how reconciliation and reporting will be handled. While not all banks formalize their procedures this way, getting this right early can help to streamline the process down the line, ensuring the same set of guidelines for every third-party client, and making oversight much easier.

LESSONS AND SUCCESSES FROM THE FIELD

There's perhaps no better way to understand how to do something than to see it in practice. To ground this report in real-world examples, we decided to highlight a few banks that have built their own BaaS operations and their experiences, successes, and challenges in entering the market. Below, we profile these institutions.

AVIDIA BANK

Avidia Bank

Avida Bank, a community bank based in Massachusetts, is building its BaaS operation using FIS' Code Connect platform. Code Connect provides a centralized API gateway and marketplace where developers and FIS partners can access FIS APIs. By leveraging Code Connect APIs, Avidia is able to provide fintechs with access to its systems to originate services. (Some services like bill pay via DirectBiller are exposed outside of Code Connect.) The bank provides access to payments services to a number of clients today, and it's now moving into deposit accounts, with one fintech currently in a test environment and another already live. Specifically, these fintechs are leveraging a set of deposit APIs provided through Code Connect that handle origination, inquiries, transfers, access to account-level information, and other necessary functions. The bank provides DDA accounts originated directly on its core.

The process for partnering with a new fintech begins with risk and underwriting, which takes between 30 and 60 days. (The bank hopes to get that down to 10 in the future.) According to Bob Conery, COO of Avidia Bank, the bank uses the same vendor risk assessment it applies to its critical vendors like FIS to determine whether or not a fintech is an appropriate fit. "The bottom line is, we are providing banking services for individuals on behalf of another entity. That fintech needs to be no less capable of maintaining security as the bank," he explained. Once the fintech has cleared the assessment, the bank shares general

terms and conditions and begins to negotiate pricing. Avidia generates revenue in a couple of ways, including through a sponsorship fee on card products, which is basis points on dollars spent, as well as per ACH and API call fees. If the fintech is also riding the bank's card payment processing agreement with FIS, it provides a buy rate and passes those costs through.

Most implementations are 8 weeks long and include pulling resources in from other teams at the bank, including from IT, compliance, and risk. Each fintech will come with its own technology stack, including its own ledgering system, that is approved by Avidia. From a technical standpoint, the bank's developers work with the fintech to connect to all of the APIs that will be necessary to run its operation. Once a fintech is up and running, it is subject to an annual review, again mirroring the bank's approach with major vendors, as well as ongoing oversight by the bank to ensure that requirements are being met in areas like AML and data security.

Avidia is a great example of a bank leveraging its existing systems and capabilities to deliver BaaS. It is, however, still very much in the process of building out its operation and plans to continue to streamline and improve its offering. In particular, Conery said, the bank is in the process of implementing an integration or API layer provided by MuleSoft that will streamline access to the bank's systems. This will allow fintechs to connect via a single API, rather than having to integrate with many different endpoints. That's likely to make the bank a much more attractive potential partner, especially in an environment where BaaS providers and other banks are streamlining access this way and setting a standard of service that fintech clients will come to expect.

cross river®

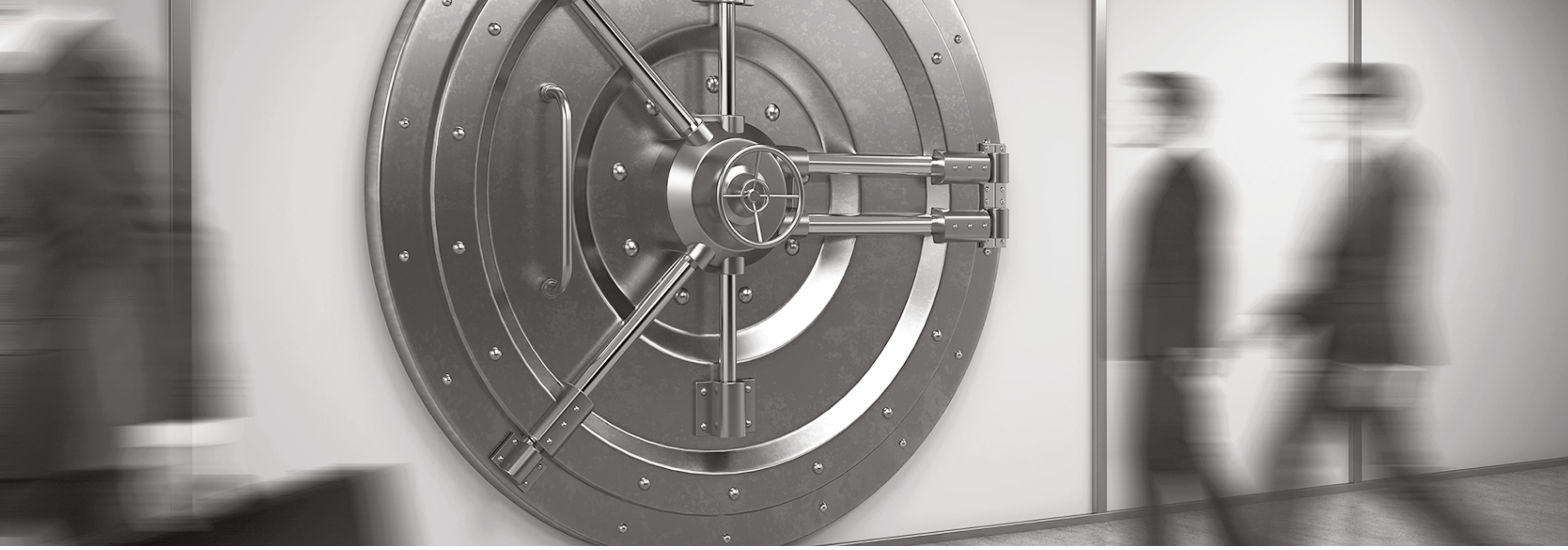
CROSS RIVER BANK

Cross River Bank is one of the most well-known BaaS operators today, and it was also one of the earliest movers in this space. The New Jersey-based bank entered the market in 2010 on the lending side. It began by funding loans that marketplace lenders were making in the wake of the financial crisis and eventually moved into wires/ACH, and then, deposits. The evolution from a product standpoint was driven by its existing relationships and how it could better serve the needs of its BaaS clients, which today include big names like Affirm and Coinbase, explained Jesse Honigberg, SVP, technology chief of staff at Cross River Bank. Currently, the bank offers lending, payments, and FBO and DDA accounts through its BaaS portfolio. It focuses on fintech and enterprise clients that can meet its stringent compliance requirements.

The cornerstone of the bank's BaaS operation today is its COS deposit core. It began development on COS in 2018 after it became clear that it would be difficult to scale its BaaS operation on its existing core system. Because COS is built from scratch, everything is designed to be consumed via API and development work is much easier as the system is modular. COS is only a deposit core; the bank's existing system still handles Cross River's legacy business, and it uses another platform built in-house, called Arix, for lending. Cross River integrates these different modules via API — for example, Arix uses the COS API for funding. Auto reconciliation is built into the system and runs in real-time with no formal "end of day" processing needed, although it can accommodate memo posting if necessary for a specific use case. All of the data is pulled together in the company's data warehouse for consolidated reporting. Fintechs in Cross River's BaaS portfolio are required to run on the COS core, which means that all activity is posted in real-time to the bank's own ledger.

On the operational side, the bank has a sales team dedicated to sourcing and bringing in fintechs as well as account teams that manage the relationships. Cross River also dedicates compliance resources to provide oversight of these relationships, including handling reporting, reviewing marketing materials, and conducting regular business reviews. For larger clients, these reviews are conducted quarterly. Currently, the bank makes money on interchange and API calls, but it sees an opportunity for new revenue models as well, including licensing its COS technology to other banks, Honigberg said. According to Andreesen Horowitz, Cross River Bank's ROE and ROA are a little more than double the industry averages of 10.8% and 1.2%, respectively.

Building and maintaining its own BaaS platform has given Cross River quite a lot of freedom, especially when it comes to developing new offerings. However, the bank has invested considerably in technology resources to make this happen. (It currently has more than 100 developers on staff.) Additionally, Cross River now has to build ongoing development into its strategy, which is a blessing and a curse — the biggest challenge is making sure not to overshoot, Honigberg explained, to ensure development and work is really connected to a client story. This is the classic trade off; the bank gets all the freedom to innovate it needs but is responsible for its own product roadmap and must be committed to allocating the necessary capital and managing the associated risk.



METROPOLITAN COMMERCIAL BANK

Metropolitan Commercial Bank is another BaaS veteran. It first entered the space through its own subsidiary, called CashZone, a check cashing services provider in New York City, where the bank is based. CashZone launched a Visa debit card backed by Metropolitan Commercial Bank in 2004, essentially becoming the bank's first BaaS client. It later sold CashZone but retained the debit card business and began bringing on additional clients in 2010. The bank primarily operates on the FBO model, though it does have a couple of clients that are opening DDA accounts directly on its core. Its BaaS operations fall under its Global Payments Group (GPG) and current clients include big-name neobanks like Revolut and Current.

Today, the bank's fintech clients generally begin by opening up an FBO. They bring their own technology stack and vendor set, including for things like KYC as well as their choice of third-party processor, all of which must go through approval. At this point, the bank is already integrated with most processors brought to the table, like Galileo or FIS, for instance, though it will integrate with new ones on a case-by-case basis. Once the fintech is onboarded, which generally takes about 3 months, most activity goes through the third-party processor selected by the fintech, though some services are provided directly; fintechs can track balances through the bank's online banking platform, for example. Functionality that is delivered by the bank directly is done primarily through APIs exposed through Metropolitan Commercial Bank's core provider. To streamline and enrich this delivery, the bank is in the process of implementing an API layer using Dell's Boomi software.

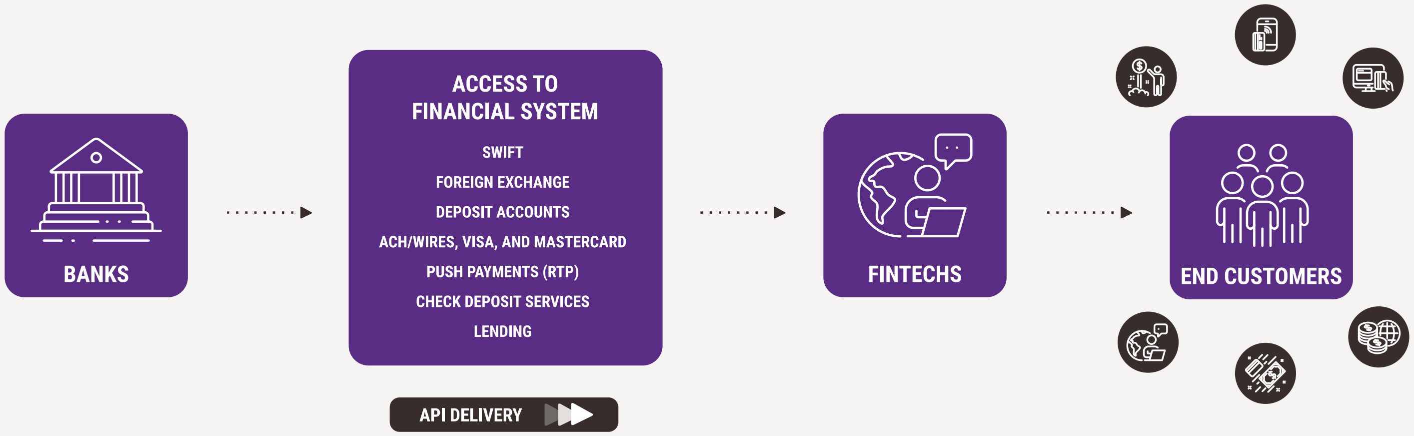
On the compliance side, Metropolitan Commercial Bank takes a three-pronged approach. The first step is the risk assessment conducted before a relationship is entered into, the second is the KYC and AML requirements placed on the fintech, and the third is ongoing oversight. According to Mark DeFazio, president and CEO at the bank, this last step is the most challenging part of the business, in large part because most of the activity doesn't flow through the bank's core. As a result, every day the bank needs to collect reports from many different processors and reconcile all of the transactions that occurred outside of the bank's environment. To make this process easier, the bank has put systems in place over time that integrate the data needed for reconciliation and deliver reports. There is a dedicated group that is charged with reconciling using those reports. In the future, the bank plans to implement a real-time dashboard powered by an integrated data warehouse that everyone can see.

Compliance is by far the most important aspect to Metropolitan Commercial Bank when it comes to its BaaS operations. In addition to its three-pronged risk management approach, the bank also embeds compliance resources throughout the BaaS business in areas like legal and operations. And each fintech is subject to an annual third-party audit. As DeFazio described it, the bank has had to build (and is still building) an enterprise-wide compliance management function for third-party oversight. "Regulators can't walk into Revolut, so they come in this door," he said. "This is where the rubber hits the road in responsibility and liability." In another year or so, DeFazio expects there to be more technology on hand to help. In fact, it's already starting to emerge — for instance, a major challenge for the bank has been monitoring changes to terms and conditions on the websites of its clients to ensure they are up to date with the latest regulation, and recently it's been able to improve that oversight by implementing web crawlers that scan for changes and automate the process.

Metropolitan Commercial Bank's investment in providing not only access to the financial system but also in delivering compliance and operational support in a repeatable way has paid off in its client list. It currently supports dozens of programs and is focused now on how it can scale operationally as it adds more and more customers, especially as some of its clients begin to hit user numbers in the millions — Current, for example, boasts 2 million customers today. [6] The bank takes a flexible approach on economics, depending on the client. Usually, it charges transaction fees combined with a deposit minimum and sometimes monthly administrative fees are included, as well.

6. Sarah Perez, Mobile banking app Current raises $131M Series C, tops 2 million members, TechCrunch, November 2020

THE BAAS VALUE CHAIN



Source: CCG Catalyst

WHERE WE GO FROM HERE

BaaS is an extremely popular topic today, and for good reason — many banks are struggling to provide customer experiences that people now expect, and it offers a way to offload that piece to a third party while still collecting not only deposits but also fees and other revenue. How to do BaaS, though, and how to do it well are really hard for most bankers to wrap their heads around. That's largely because there are so many options — direct or BaaS provider? FBO or DDA? What about lending? And any kind of BaaS setup opens the bank up to risk and potential compliance issues. That's why taking the time to tailor the concept of BaaS to the bank is so important. For those going the direct route, this is especially important, because it's essentially a choice to go without help in favor of control.

For any bank getting started, it's critical to begin with what you want to do and what you're capable of. Some BaaS providers today would be very happy to pursue an FBO model but are starting with DDAs because they haven't figured out the reconciliation piece. Others have core infrastructure limitations that make the DDA option a nonstarter in their eyes. Moreover, BaaS may simply not be an option for some, no matter how attractive it might seem, especially if resource issues come into play or a bank simply doesn't have the risk appetite. The point is that each bank has to weigh all of the considerations that a potential BaaS unit comes with and chart its own journey from there. As we so often say in financial services, the answer is never one-size-fits all.

ABOUT US

RESULTS-ORIENTED AND CLIENT-FOCUSED

CCG Catalyst Consulting (www.ccgcatalyst.com) is a global management consulting firm specialized across financial services focused on banking and fintech. The financial services industry is in a disruptive stage. The velocity of change is accelerating. Banks & Credit Unions are consolidating with Fintech maturing. Ongoing challenges related to Open Banking, Challenger Banks, AI, Synthetic Data, Digital Experience and so much noise. There are so many strategic options that decision-makers become overwhelmed.

As a firm, we collaborate with our clients to bring market knowledge, opportunity, research, and vision. We form a relationship to guide our clients through the velocity of change that ignite the future of our industry. As a leader, we bring expertise and vision to drive strategic value to our clients and the financial services industry. As consultants we utilize a strategy driven approach with our award winning 4D™ methodology connect to strategy, innovation and provide a broad range of services in digital transformation, technology, strategy, and operations. The firm's industry experts leverage decades of experience to improve business planning, strategies related to digital experience, technology, payments, lending, retail, operations, and organization. The firm has a unique approach for contract negotiation, evaluation, implementation, and merger acquisitions.

Our clients expect us to be the trusted subject matter expert and lead them through the current and future state of business confusion.

CONTACT DETAILS

Paul Schaus
Founder & President
Chief Executive Officer
paulschaus@ccgcatalyst.com

Kate Drew
Director of Research
katedrew@ccgcatalyst.com

PAUL SCHAUS is the President and Chief Executive Officer. Throughout his successful career Paul has been a banker, management consultant, strategist, thought leader and strong advocate to the financial services industry. Paul has advised clients and led major engagements globally, from community banks to global institutions on strategy, business planning, tactical performance, profitability improvement, governance and management development. He has advised banks, fintech, credit unions, and financial technology vendors on business and technology strategies.

KATE DREW is the Director of Research at CCG Catalyst. She spearheads client-facing research projects on fintech topics including open banking, digital channels, payments, lending, blockchain, artificial intelligence, digital wealth management, and others. Her team leverages quantitative data as well as conducts field study based on desk research, conference and event findings, and interviews with prominent industry leaders at fintechs, banks, and other financial and nonfinancial institutions. Kate's approach centers on bringing voices into data and providing perspectives informed by real experience inside of financial services companies.