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FINTECH – WHAT YOU ALREADY KNOW AND HOW TO ADDRESS IT

While the exact definition of fintech remains open to debate, we can all agree that fintech is an industry which has, is and will continue to impact the landscape of banking. The University of Pennsylvania is the home of the Wharton FinTech Club and I feel they offer a concise and simple definition of fintech which will serve as our common basis of understanding for this piece. *>Fin Tech *noun* : an economic industry comprised of companies that use technology to make financial systems more efficient.* Given the digitization of everything, businesses in all segments are focused on increasing ease of use and engagement through technology, so the Wharton definition works well. Investors are flocking to back fintech businesses – a recent white paper by Citibank reveals that $19 billion was invested in the fintech industry in 2015, with 73% of this investment focusing on the personal and small business segments (https://www.citivelocity.com/citigps/ReportSeries.action). These figures cannot be ignored. But you already know this. The rise of the fintech industry has been well documented, but pushing a doomsday message of bank extinction is not accurate, and it's certainly not fruitful.

To put some context around the state of situation, the same Citibank whitepaper explains, "only about 1% of North American consumer banking revenue has been disrupted by fintech players." This doesn't mean that legacy financial institutions should simply ignore the issue and hope it goes away, but it should give banks and credit unions comfort that they have time to devise a go-forward plan. Given the evolving demands of an increasingly discerning and digital customer base, community and regional banks, and credit unions must find a way to operate at the confluence of technology and human interaction. Fintech, however, has an advantage here as these companies can concentrate on a single business line, where banks have to cover their flanks as well. But banks and CUs, too, have their advantages – customers. Cost-effective customer acquisition for fintech is the biggest hurdle for any fledgling start-up. Given the headwinds brought on by the fintech revolution, smart institutions who are determined to remain relevant are taking proactive steps to adapt to this changing landscape.

GAP ANALYSIS – THE DISTANCE BETWEEN FINTECH AND LEGACY INSTITUTIONS

Todd Harris, CEO of $2B Tech CU, and former SVP of Finance and Strategic Planning at Silicon Valley Bank, is dead-set on the strategic digital enhancement of Tech CU. Being on the cutting edge of technology and banking offerings is part of the company's value proposition and brand promise. Located in the heart of Silicon Valley, Tech CU serves employees of some of the most innovative companies on the planet, including the likes of Tesla, eBay and Facebook, to name a few. These customers demand innovation or they'll go elsewhere. Tech CU ran a gap analysis of their offering and how it compared to fintech competitors. Results showed that the gap between electronic interfaces was small, but the perception of the gap was much greater. Therein lies the conundrum that Harris and Tech CU are facing. Most fintech companies tend to deliver on one value proposition: free credit score, tracking your budget, 401(k)s, loans and investments. Tech CU sees itself as all of these things rolled into one, and more. The credit union is well aware of the marketplace and what fintech competitors are doing to grab a piece of it. Tech CU has updated its online and mobile platforms, and is transforming their branch footprint to incorporate interactive technology – all geared towards showing they are ready to take on the challenge.

PARTNERING WITH TECHNOLOGY INTERMEDIARIES

Many institutions are partnering with technology intermediaries to simplify and reduce the cost of technological innovation. ***Troy Bradley, Chief Technology Officer at FIS***, shared that FIS believes in having their bank clients invest their dollars on top of FIS's. As one of the largest financial services technology providers globally, FIS is on the leading edge of innovation, and with their massive customer base they have access to a captive set of product managers (the banks who are dealing directly with the end customer) who provide input as to FIS's product set and roadmap. FIS calls this "ideation" – where they are getting direct access to the voice of the customer (and the customer's customer), to accelerate innovation, and in some instances, create it. Troy went on to explain that by working with FIS, banks don't need to invest in technological advancements which will become commodities, instead giving these institutions the opportunities to invest in initiatives unique to them, like marketing or community events. As an example, Troy shared how FIS's community and regional banking customers were leveraging Cardless Cash (where a phone scans a QR code and automatically pays for an item) a year prior to the global banks who were still trying to figure out the bugs. These are the sorts of offerings which are now commodities to many banks and FIS was able to lead the charge, leaving their bank clients to focus on what they do best – banking.

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BRING INNOVATION IN-HOUSE

$10B Golden 1 Credit Union, the sixth largest credit union in the country, has taken a progressive approach to addressing technological innovation by creating a new role within the senior leadership team – the Chief Technology and Innovation Officer. While the title is unique, the role is even more so. This CTIO's main charge is to establish the institution's technology innovation philosophy and define a strategy for continuous innovation to address the changing landscape. Where a CIO is thinking more about keeping the business systems and technology running, the CTIO at Golden 1 focuses solely on innovation, while technology execution remains with the operations team. Golden 1 was not afraid to look outside of banking and credit unions to ensure they found a true innovator to bring diversity of thought to the institution. ***Golden 1 hired Val Scott as their CTIO***. She is a true technologist with a 25-year track record of success as a C-level technology leader in a myriad of industries including financial services, consumer products, and retail. With this hire, Golden 1 is prepared to meet the evolving desires of an increasingly sophisticated customer base (the sophistication is amplified given the proximity to Silicon Valley). There are technologists like Val who would jump at the opportunity to work for a stable financial institution instead of choosing the inherent risks that go along with joining a start-up. But financial institutions must become a place which is open to innovation in order to attract this sort of leadership.

PARTNERING DIRECTLY WITH FINTECH

Fintech companies can bring cutting-edge technology to community banks and credit unions in a way that benefits both parties, at a much lower cost, and a much faster speed-to-market than adopting a "build-it-in-house" strategy ever could. Better yet, this is possible without triggering conflicts of interest from a customer acquisition and product distribution standpoint – core competencies of banks both large and small.

This principle was the primary impetus behind the community bank and credit union offering ***Personal Capital***, a digital financial advisor and wealth management firm, launched this summer. By co-branding Personal Capital's personal financial management platform with credit union and community bank partners, banks can offer a superior digital experience to their customers without investing a dollar in technology development, as well as provide a fiduciary-compliant wealth management offering to customers.

"Community Banks and Credit Unions are, and will continue to be, a keystone of the U.S. financial system" says ***Mark Goines, Vice Chairman of Personal Capital*** and a long-time fintech investor. "They bring deep relationships with their extensive customer base, and should look at innovation from fintech firms as an excellent source of competitive differentiation, especially as larger, legacy financial institutions invest more in customer-centric technology." Goines continued, "In an analysis we performed on our user base, we found that the average credit union and community bank customer has a relationship with 5.6 financial institutions. In general, credit unions and community banks only capture about 30% of their customer's overall wallet share – a huge opportunity for these banks." Partnering with Personal Capital gives banks an opportunity to increase share of wallet with existing customers, and to capture a portion of wealth management fees that often go to larger, legacy asset managers.

THE FUTURE

We can all agree that the future of banking will look different than it does today. And we already have a multitude of examples of this evolution. From one direction, we have ***Bank of the Internet***, the country's oldest internet-only bank, looking to capitalize on the efficiencies created by being a digital institution. And on the other side, we recently saw the first foray of a technology firm trying to purchase a bank with ***Veritec*** when they signed a nonbinding LOI to acquire First Citizens Bank of Polson. In the current and ongoing market, cost control and the expansion of mobile and internet services are now mandatory objectives in order to expand return on assets. Given this necessity, financial institutions have a variety of potential solutions. As outlined above, the gap between fintech and legacy financial institutions is not as big as the perception. But banks and credit unions need to stop this gap from growing even further. While many smaller institutions feel innovation is the realm of the mega banks, we disagree. Community and regional banks and credit unions are nimbler and can innovate and implement change much faster. Legacy financial institutions already have the greatest asset – customers – but these institutions must evolve in order to find the best way to serve these customers before they go elsewhere. We are confident that banks and credit unions who can deliver on a value-added customer experience will thrive.

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About the Firm and the Author

McDermott & Bull is a full-service executive search firm serving the Western region of the United States. The Firm's Financial Institutions Practice Group partners with boards and senior leadership teams to align talent strategies with business strategies for banks, credit unions, fintech companies and investment advisory firms. Clientele include the likes of BNY Mellon, First Republic Bank, Silicon Valley Bank, Golden 1 Credit Union, First American Trust Company, Bank of Marin, Technology Credit Union, Western Federal Credit Union, Luther Burbank Savings, East West Bank, Bank of the Cascades, Exchange Bank and United Capital.

Brandon Biegenzahn is a Partner with McDermott & Bull, and he co-chairs the Firm's Financial Institutions Practice Group. Brandon is a corporate attorney by trade having practiced with Sheppard, Mullin, Richter & Hampton, and Buchalter Nemer in their corporate finance and real estate finance departments, respectively. Brandon received his Bachelor of Arts from the University of Southern California and his Juris Doctorate from Penn State.