Aite Novarica

JULY 2021

FINTECH COLLABORATION

REAL OPTIONS FOR COMMUNITY BANKS

PREPARED FOR:

synctera

TABLE OF CONTENTS

JULY 2021

FINTECH COLLABORATION

Real Options for Community Banks

LIST OF FIGURES

LIST OF TABLES

EXECUTIVE SUMMARY

Aite-Novarica Group's study Fintech Collaboration: Real Options for Community Banks describes why Banking-as-a-Service (BaaS) has become a major trend in the financial industry, supporting financial technology firms' needs for easy access to banking services. The study demonstrates how small and midsize financial institutions can offer BaaS to fintech firms and create new revenue streams while keeping investment and resource commitments to a minimum.

Key takeaways from the study include the following:

- Digital banking capabilities will become a larger influence on consumers' willingness to do business with a financial institution, driving customers to modern digital banks. Easy-to-use online banking capabilities are an important consideration when switching banking relationships.
- Fintech firms demonstrate strength in digital banking experiences, but they need bank sponsorship to offer card issuing, lending, money transfers, and other banking services. Fintech firms also generally have limited experience in compliance processes related to Know Your Customer (KYC) and Customer Identification Procedures (CIP). Banks have responded by providing BaaS to allow fintech firms and neobanks to leverage bank know-how and capabilities to reduce costs and scale more quickly.
- As more and more fintech firms are looking for bank partners to provide banking services, there is a significant opportunity for banks to offer a BaaS solution and develop new relationships with fintech firms, creating new revenue streams.
- Small and midsize institutions can effectively partner with fintech firms through a platform that provides the technological connective tissue and enables service delivery.
- Synctera's Fintech-as-a-Service (FaaS) platform allows community banks to provide a range of banking services to fintech firms, creating new revenue streams that go beyond just interchange revenue share and include KYC, ledger, and other services.
- For fintech firms, Synctera's FaaS platform simplifies the integration of banking card services into their offering. Fintech firms only need a single contract with the bank to get access to banking services through a single set of APIs, rather than contracting

and integrating with multiple service providers. Fintech firms will therefore need fewer resources to acquire additional partnerships and develop new business.

- One bank's story demonstrates the art of the possible in fintech firm/bank partnerships, leading to profitable new business.

INTRODUCTION

The spectacular growth of the fintech sector has accelerated the development of BaaS as a key proposition to service fintech firms' needs for easy access to banking services. BaaS enables the provision of complete banking processes, such as deposit accounts, loans, payments, or compliance as a service to fintech firms and other nonbanks using an existing licensed bank's secure and regulated infrastructure. This way, financial institutions can generate new revenue streams from partnering with fintech firms, reclassifying fintech firms as partners rather than competitors to financial institutions. This research demonstrates the growing possibilities for collaboration, meaningful partnerships, and new sources of business and revenue though fintech companies.

Successfully growing BaaS/partner bank opportunities requires vision, skills, culture, and technology. This report accomplishes the following:

- Describes the trend to BaaS as a solution to the banking service needs of fintech firms and neobanks
- Describes the challenges that community banks face in developing BaaS and the options they have to implement BaaS solutions
- Showcases Synctera's technology by describing its features and the functions that enable small and midsize institutions to functionally collaborate with fintech firms, including the platform's planned roadmap for the future
- Includes a case study of Synctera's customer—Coastal Community Bank (CCB)—as a working example of current possibilities for similarly sized financial institutions to leverage platform technologies

METHODOLOGY

This study was completed using Aite-Novarica Group's extensive research library as well as interviews and briefings with the chief executive officer (CEO), head of product management, and chief technology officer of Synctera (the sponsor of this report) as well as CCB's CEO. In addition, the research incorporates interviews with other executive personnel at community institutions involved with fintech, along with research of publicly available presentations and bank financial reports.

BANKING FOR FINTECH: THE BAAS PROPOSITION

The digital transformation has created a new paradigm for how consumers expect to interact with their financial institutions. Consumers have become used to accessing their information in real time, 24/7, and through any device or channel. Many banks, large and small, struggle to offer the experience that customers expect, leaving an opportunity for new entrants to occupy the digital banking space. Some fintech firms have been successful in delivering superior digital customer propositions and acquiring large customer bases, attracting the attention from investors around the world. In 2020, the global investment in fintech firms was US$33.9 billion. In the U.S. alone, there are more than 10,000 fintech firms of one type or another. From financial institutions' perspective, more than two-thirds of financial services executives believe fintech will impact their business, especially in the digital wallet and payments sector.[1]

Competition from fintech firms urges incumbent banks to accelerate their strategic investments in digital banking as well. This makes the space very dynamic, giving rise to a set of interrelated market trends that shape the digital banking market (Table A). These market trends are explored in more detail in the following sections.

TABLE A: THE MARKET

Market trends	Market implications
The shift to digital banking accelerates.	The COVID-19 pandemic has strengthened consumer demand for digital banking solutions. Digital banking capabilities will become a larger influence on consumers' willingness to do business with a financial institution and their willingness to stay with their existing financial services provider.
Fintech firms turn into neobanks.	A growing category of fintech firms are the neobanks, i.e., fintech firms that operate under the license of a financial institution or have obtained their own banking license. Neobanks are challengers to incumbents, but they also partner with banks to get access to banking services and scale more quickly. Banks need to develop a strategy to partner with neobanks and generate new revenue.

1. "Fintech—Statistics & Facts," Statista, February 1, 2021, accessed July 2, 2021, https://www.statista.com/topics/2404/fintech/#dossierSummary__chapter3.

Market trends	Market implications
BaaS becomes mainstream.	Fintech firms and neobanks are strong in the provision of digital banking experiences, but they need bank sponsorship to offer card issuing, lending, money transfers, and other banking services. Fintech firms also generally have limited experience in compliance processes related to KYC and CIP. Banks have responded by providing BaaS to allow fintech firms and neobanks to leverage bank know-how and capabilities to reduce costs and scale more quickly.

Source: Aite-Novarica Group

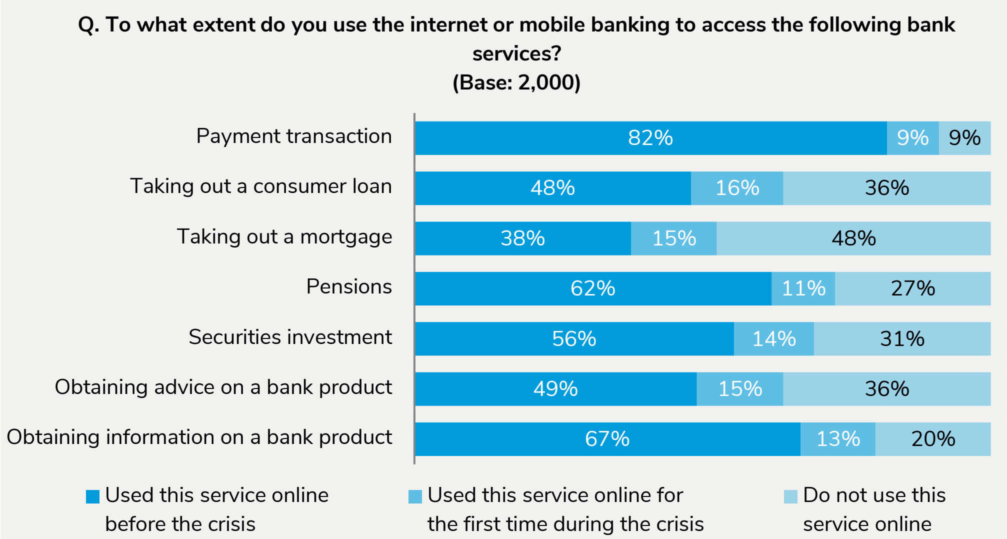
THE SHIFT TO DIGITAL BANKING ACCELERATES

Driven by the global pandemic, digital transactions grew 250% across financial institutions in 2020, transforming millions of traditional customers into first-time digital customers.[2] Digital banking adoption and usage were already outpacing branch volume, but with branch closures, customers' reluctance to visit branches due to the COVID-19 pandemic, and overburdened call centers, many customers are embracing digital-first banking as a new way of life (Figure 1).[3]

2. See Aite-Novarica Group's report Workplace Distancing: Adapting Fraud and AML Operations to COVID-19, April 2020.

3. "COVID-19 Boosts Digitalisation of Retail Banking," Deloitte, accessed July 2, 2021, https://www2.deloitte.com/ch/en/pages/financial-services/articles/corona-krise-digitalisierungsschub-im-retailbanking.html.

FIGURE 1: INCREASED USE OF DIGITAL BANKING AS A RESULT OF THE COVID-19 PANDEMIC

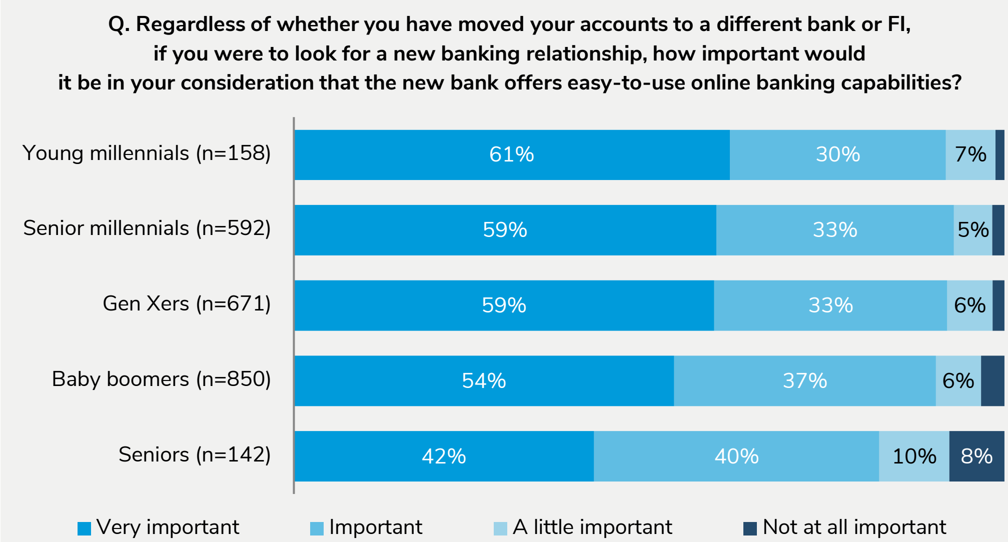


Source:Deloitte

As a result, digital banking capabilities will become a larger influence on consumers' willingness to do business with a financial institution, driving customers to modern digital banks. Easy-to-use online banking capabilities are an important consideration when switching banking relationships (Figure 2).[4]

4. See Aite-Novarica Group's report *Attracting and Retaining the Digital-First Customer*, June 2020.

FIGURE 2: IMPORTANCE OF EASY-TO-USE ONLINE BANKING CAPABILITIES



Source: Aite Group's survey of 2,413 U.S. consumers, Q1 2020

This holds for all age groups, with over 90% of consumers (except seniors) saying that easy-to-use online banking is important or very important. Fintech firms are well-positioned to capitalize on this trend, with their fully digital, customer-centric, mobile-banking-first approach. This means that banks that are lagging in their digital transformation are at risk of losing business and client relationships to fintech firms that engage in banking activities to end users. At the same time, there are opportunities for cooperation as fintech firms and banks develop partnerships to go to market together.

FINTECH FIRMS TURN INTO NEOBANKS

Fintech firms can be classified into three core categories:

- **Technology providers:** Fintech firms that deliver technology solutions to financial institutions in a business-to-business model but don't provide banking services themselves
- **Neobanks:** Fintech firms that deliver banking services such as deposits, loans, and payments directly to end users (consumers or businesses)
- **Embedded finance:** Existing businesses with communities—for example, Thumbtack or Care.com—that want to offer financial services to their customers

The last two are the fastest growing categories of fintech firms that interact with their customers exclusively through digital channels and have differentiated their offering from that of traditional banking by focusing on the customer experience.[5] The expectations are high for these new players. Analysis from Fincog shows that the market typically values these fintech firms at US$750 to US$1,000 per customer.[6] As a result, neobanks have attracted massive funding from investors. Table B shows some high-profile examples for the U.S. market.

TABLE B: EXAMPLES OF NEOBANK FUNDING IN THE U.S.

Neobank	Customer proposition	Founded	Total funding (In US$ millions)	2020 to 2021 funding (In millions)
Chime	Consumer banking	2013	1,500	534
SoFi	Personal finance	2011	3,000	370
Varo Money	Consumer banking	2015	482	284

Source: Crunchbase

Neobanks need access to a banking license to operate in the U.S. market. During 2020, some fintech firms have considered or applied for a national bank charter, including Square, SoFi, and Varo Money. However, the majority of fintech firms do not have the means to apply for a banking charter, as de novo banking is not simple. Launching a new banking service requires the fintech firm to integrate with multiple service providers, manage multiple contractual relationships with multimillion-dollar contract commitments, and manage operational and compliance risk. That is the reason that many fintech firms seek a partnership with existing banks to operate under the incumbent's banking license and get access to banking services to reduce time to market

5. See Aite-Novarica Group's report Neobanks: The Bumpy Road to Profitability, December 2020.

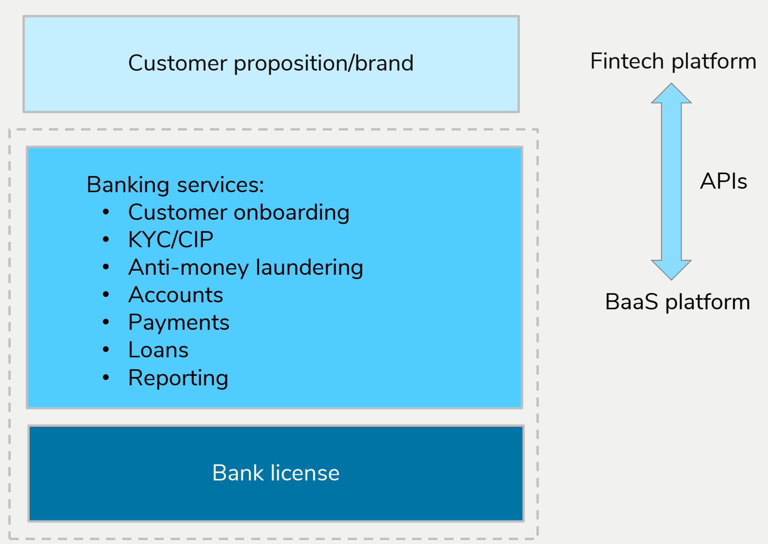
6. "Fincog Analysis on Company Valuation and Value per Customer," Fincog, February 4, 2020, accessed July 2, 2020, https://fincog.nl/publications/11/value-per-customer.

and scale more quickly. This trend opens the opportunity for banks to provide BaaS and generate new revenue from fintech partnerships.

BAAS BECOMES MAINSTREAM

BaaS enables the provision of complete banking processes, such as deposit accounts, loans, payments, or compliance as a service to fintech firms and other nonbanks using an existing licensed bank's secure and regulated infrastructure (Figure 3). The services are delivered through the bank's API platform or through a third-party platform that the bank has contracted with.

FIGURE 3: SCHEMATIC OVERVIEW OF BAAS



Source: Aite Group

Examples of banks providing BaaS are Goldman Sachs (partnering with Apple for its credit card product) and Bancorp Bank (partnering with Chime for debit cards and deposits). According to venture capital firm Andreessen Horowitz, there were more than 30 BaaS partnerships between banks and fintech firms in 2020. A survey of partner banks' returns shows that many operate at profitability levels two to three times above average.[7] As more and more fintech firms are looking for bank partners to provide

7. Rex Salisbury and Anish Acharya, "The Partner Bank Boom," a16z, June 2020, accessed July 2, 2021, https://a16z.com/2020/06/11/the-partner-bank-boom.

banking services, there is a significant opportunity for banks to offer a BaaS solution and develop new relationships with fintech firms, creating new revenue streams while continuing to focus on their community.

BAAS FOR COMMUNITY BANKS

With nearly 50,000 locations nationwide, community banks constitute 99% of all banks, employ more than 700,000 Americans, and are the only physical banking presence in one in three U.S. counties.[8] These banks, being the backbone of the U.S. banking system with their strong local presence and relationships, are facing headwinds on multiple fronts. The low interest rate environment is heavily compressing net interest margins, and community banks are struggling to compete with the bigger banks for deposits they need to fund local lending. They also face difficulties to keep pace with the increasing speed and complexity of digital banking innovation. Engaging in partnerships with fintech firms can unlock new opportunities for community banks to generate revenue and stay competitive.

OPPORTUNITIES AND CHALLENGES

In order to monetize this BaaS opportunity, community banks are also facing a number of challenges. Figure 4 provides a SWOT analysis for community banks considering a BaaS offering.

8. "About Community Banks," ICBA, accessed July 2, 2021, https://www.icba.org/about.

FIGURE 4: SWOT ANALYSIS FOR COMMUNITY BANKS BAAS OFFERING

Strengths	Weaknesses
• Banking license • Compliance expertise • Strong local presence and relationships	• Lack of resources and fintech expertise • Technical and operational constraints • Heavy compliance burden
Opportunities	**Threats**
• Generate new fee-based income • Compete with large banks for low-cost deposits • Ability to capture higher interchange fees than large banks	• Regulatory and commercial risk due to lack of visibility into fintech partner • Operational risk, e.g., from data breaches, system outages

Source: Aite Group

Community banks can leverage their banking license and compliance expertise to attract fintech firms that are looking for bank partnerships. The number of available bank sponsors is currently limited, restricting choice for fintech firms with potential upward pressure on pricing.

On one hand, from a business perspective, community banks are well-positioned to play in this space. The BaaS channel presents a clear growth opportunity with no risk of cannibalizing their own banking business. Banks can generate fee-based income by charging fintech firms for access to the BaaS platform, agree on a revenue share, and/or charge for individual services. They can capture higher interchange fees than large banks, as they can profit from the exemption to the Durbin amendment on interchange caps. Community banks can also compete against large banks for low-cost deposits by partnering with fintech firms active in consumer banking.

Banks can specialize in different forms of partnerships, such as consumer banking (e.g., Bancorp, Green Dot, NBKC bank), consumer lending (e.g., Cross River Bank, WebBank), SMB lending (e.g., Celtic Bank), or card issuance (e.g., Sutton Bank).[9]

9. For an overview, see “Partner Banks and Fintech Partnerships,” a16z, June 2020, accessed July 2, 2021, https://info.a16z.com/rs/382-JZB-798/images/partner-banks-and-fintech-partners.pdf.

On the other hand, however, community banks face several challenges when they engage in fintech partnerships. Banks may face the following risks:

- **Resource limitations:** There may be a lack of resources and expertise to support fintech firms.
- **Technical and operational constraints, for example, due to legacy infrastructure:** These constraints can delay implementations and may require costly manual processes to overcome back-office limitations.
- **Regulatory risk:** Banks may have limited visibility on their partners' customer transactions and compliance processes, exposing the banks' license to regulatory risk.
- **Commercial risk:** The unknown commercial upside for the fintech firm means banks may only want to work with the largest or best-funded ones.
- **Operational risk:** Aite-Novarica Group research found that exposing bank services through APIs increases the risk of cyberattacks and security breaches if not carefully managed.[10]

Large banks could overcome risks such as these. However, for community banks, addressing all of these at once is cost-prohibitive, and another route must be found. Most community banks will not be able to invest in and create a "digital brand" that competes with the fintech firms, and, as such, should think about how they can leverage their banking license to generate revenue by supporting fintech firms in their mission.

10. See Aite-Novarica Group's report Chasing Shadows: Securing APIs in a Digital Economy, March 2020.

OPTIONS FOR BAAS IMPLEMENTATION

Community banks have several options to implement a BaaS solution. They can develop the capability in-house or work with technology partners to scale more quickly.

In-House Development

Developing a BaaS proposition in-house can be workable, but reviewing the risks outlined previously, going it alone presents several hurdles to overcome:

- Fintech relationships take legal, operational, and regulatory work. The bank must determine whether it has the resources to first solicit, then negotiate, develop, launch, and support its BaaS relationships. Once the fintech relationships are up and running, can the bank sustain the effort it takes to add new fintech firms to the portfolio? Can the bank readily offer new or different services through other specialized fintech firms?
- As the case study in this paper later demonstrates, absent specific technology, the operational aspects of working with fintech firms require manual effort. This takes more human resources and can quickly result in a business bottleneck. It can also subject both the bank and the fintech firm to human error, either limiting the size of the opportunity or, worse, delivering poorly to the end customer.

For the largest banks, going it alone may well be the preferred option; they can create the bespoke technology and invest in the human resources needed to be a strong fintech partner. This is not true for most small and midsize institutions, at least not at scale, so other options may serve those institutions better.

Rely on Core Vendors

Major core banking and other financial system vendors are working to expose core system functionality through API libraries. This trend is driven by the open banking concept rapidly growing into the mainstream globally. As of this writing, the state of development of libraries varies greatly between core providers. The key functions core banking vendors expose with APIs are still mostly limited to that core vendor's capabilities. For this reason, knowing if the platform is independent will be important to making an informed choice. For example, the bank may require that independence since it allows the bank to change either the core vendor or the fintech partner without significant change to the platform. Also, the bank has to assess the contractual conditions with the core vendor to ensure a flexible fee structure without long-term commitments or high fixed fees.

These API libraries will grow as the financial services industry increasingly sees competitive advantage redefined in terms of how open and accessible the technology is to any front-end system, including fintech systems.

Leverage a Platform

The emergence of "platform" technology to help financial institutions partner with fintech firms is a phenomenon of recent years. A platform, in the sense used in this research and in its simplest form, is a technology application that enables services to pass between the fintech firm and the sponsor bank. Not all platforms are alike, and within the term alone, there are a wide variety of services. One may enable KYC and Office of Foreign Assets Control (OFAC) checking for consumer relationships (e.g., for opening a checking account). Another may provide near-real-time business-to-business accounts payable processing through an international money transfer, currency to currency. Yet another may manage risk on both sides of the partnership.

The use of a platform ensures that the fintech system is getting the data and steps it needs to deliver its service and conform to standards and regulations that the bank, as the BaaS source, requires. Table C summarizes these options.

TABLE C: PROS AND CONS OF FINANCIAL INSTITUTIONS/FINTECH OPTIONS

OPTION	PRO	CON
In-house development	The bank and the fintech firm can create very specific and unique relationships and services.	This requires a significant investment and commitment to the technology before either sees returns.
Rely on core vendors	As API libraries grow, the bank need not invest in technical resources, opting to take the vendor's solution.	A core vendor may have limited ability to leverage APIs outside its own systems, and it makes the bank a solution "taker," which can limit opportunity. Also, the bank has to assess the contractual conditions with the core vendor to ensure a flexible fee

OPTION	PRO	CON
		structure without long-term commitments or high fixed fees.
Leverage a platform	Given the growing number of platform providers, banks can choose which vendors and services best fit their business strategy. They can, for instance, choose to work with platform providers that align the business models of banks, platforms, and fintech firms and reduce cost risks for banks.	Platforms' options and capabilities range widely. Due diligence on both current capabilities and the functional roadmap are needed.

Source: Aite-Novarica Group

SYNCTERA'S PLATFORM APPROACH

Synctera is a recent entrant as a technology platform vendor helping to link banks with fintech firms. Its genesis was driven by its first financial institution customer, CCB, which realized the demand of fintech firms to get easy access to banking services. CCB recruited a Canadian investment firm to help build a platform product, which ultimately resulted in Synctera.

Synctera launched in July 2020. CEO Peter Hazlehurst joined the company in September, and by year-end, Synctera received seed funding of US$12.4 million from a mix of angel investors and venture capital firms (led by Lightspeed Venture Partners).

The platform onboarded its first financial institution/fintech relationship in December 2020, when CCB partnered with One Finance (ONE), a fintech firm focused on U.S. consumers' money management. ONE offers open comparisons to competitors and features such as early access to funds, premium savings rates, and sharing funds with others.

As a new platform, Synctera has automated some of the processes necessary for debit, credit, and line-of-credit delivery and maintenance, along with automating some of the end-customer application, approval, and onboarding to the banking back end. However, the full set of APIs is being developed over the next six to nine months and recently included a launch in April of KYC-as-a-Service, Ledger-as-a-Service, Payments-as-a-Service, and Remote Deposit Capture-as-a-Service. This way, Synctera offers a suite of services that a fintech firm requires for growth, allowing the bank sponsor to generate income from beyond interchange revenue alone.[11]

SYNCTERA'S COMMERCIAL MODEL

To best understand what the Synctera platform offers, a review of how this relationship is established and works among the financial institution, the fintech firm, and Synctera is necessary. The description of the contract, range of services, and operational processes follows.

First, the contract relationship between the parties needs to be clearly understood. The financial institution enters into two agreements. The agreement with the fintech firm

11. The traditional business model is a revenue share of interchange transaction fees. Typically, fintech companies earn between 90 bps and 100 bps of interchange, with the bank keeping about 40 bps.

includes risk sharing, responsibilities, exit strategies, end-user onboarding duties, and day-to-day operational duties, as well as other terms and conditions the financial institution’s legal advisors would require. Because many of the banks that will join Synctera’s marketplace are new to FaaS, Synctera provides a toolkit and draft contract to help the bank manage the onboarding of each new fintech firm from a compliance, regulatory, and operational point of view. Synctera also provides suggested pricing to the bank to help shape the partnership, but the bank retains full control of the pricing to the fintech firm.

The financial institution also enters into an agreement with Synctera as a service provider, delivering functionality to the fintech firm. The financial institution chooses from a list of operational services Synctera provides, allowing it to determine how much of the operations it wishes to outsource.

Regarding revenue and income, Synctera has a simple model that aligns with the goal of shared success. The financial institution and the fintech company agree on a range of fees and revenue shares (if appropriate). These are based on markups of the costs of services that Synctera provides to the bank. Synctera receives a 50-50 net revenue share with the community bank for all fintech-related revenue supported by the Synctera platform. These may include interchange, float on deposit balances, transaction fees, payment processing, card issuance, and lending spread. The arrangements along these lines can be complex or simple, and may vary between fintech companies.

The basic contractual relationships are captured in Figure 5.

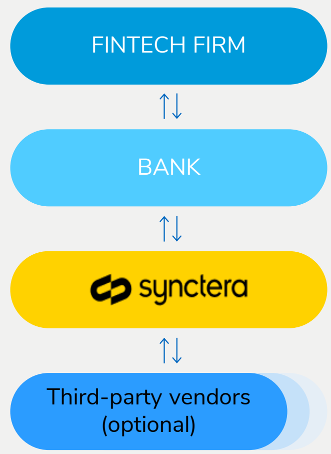
FIGURE 5: SYNCTERA/FINANCIAL INSTITUTION/FINTECH FIRM BUSINESS RELATIONSHIP

The bank and the fintech firm enter a contract to capture each party's role in partnership banking and FaaS, including negotiated transactional costs.

Synctera provides FaaS on behalf of the bank to the fintech firm.

Synctera and the bank enter a contract for Synctera to provide BaaS to the bank based on revenue sharing and transactions.

The bank may choose to purchase additional third-party services, which Synctera then negotiates and contracts on behalf of the bank.



Source: Synctera

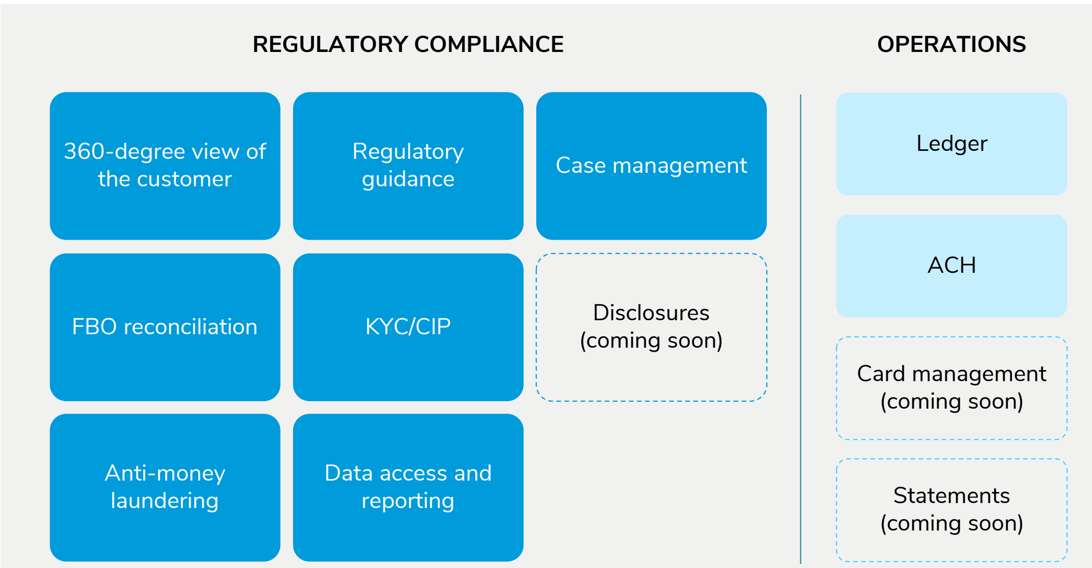
SYNCTERA'S FAAS PLATFORM—HOW IT WORKS

Synctera's Software-as-a-Service (SaaS) platform creates the contracted connections between the bank and the fintech firm. Key to the service is how data is handled:

- The Synctera platform consumes real-time API and segment messages as well as batch data from the fintech firm and its partners (e.g., Galileo, Marqeta, Finxact).
- The Synctera platform consumes batch data (e.g., ACH, transaction files) from the bank.
- The Synctera platform exchanges requirements data with third parties in real time (API) or as a batch.
- The Synctera platform provides a host of capabilities (e.g., KYC results, marketing coordination, case management, billing, and reconciliation tools) through a unified dashboard to both the bank and the fintech firm.
- The Synctera platform offers a unified view of all of one fintech firm's data potentially across partners, as well as all of one bank's data across fintech firms.

Synctera's initial platform offering has focused on helping the fintech firm navigate regulatory compliance and disclosure requirements, and ensure it is communicated to the bank. Under its current roadmap, Synctera will continue to enrich its existing service options as well as develop new services over time. Thus, Synctera offers the financial institution the option to purchase the service or continue to do that service itself. An abbreviated and high-level description of service options is reflected in Figure 6. While these descriptions are brief, in-depth review of exactly what is to be delivered in each of them needs to be part of the financial institution's due diligence process before entering into an agreement.

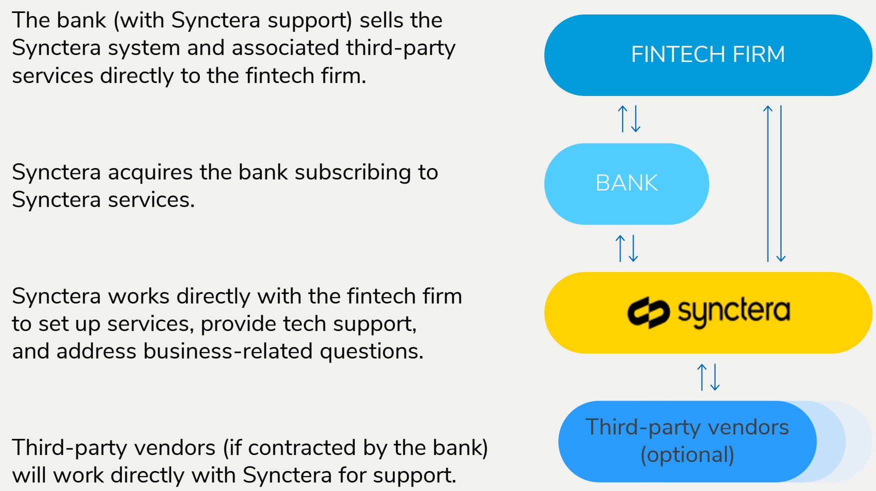
FIGURE 6: SYNCTERA'S FAAS PLATFORM



Source: Synctera

Once agreements are in place and options are chosen, the onboarding and day-to-day servicing flow begins. This is captured in Figure 7.

FIGURE 7: SYNCTERA/FINANCIAL INSTITUTION/FINTECH FIRM WORKING RELATIONSHIP

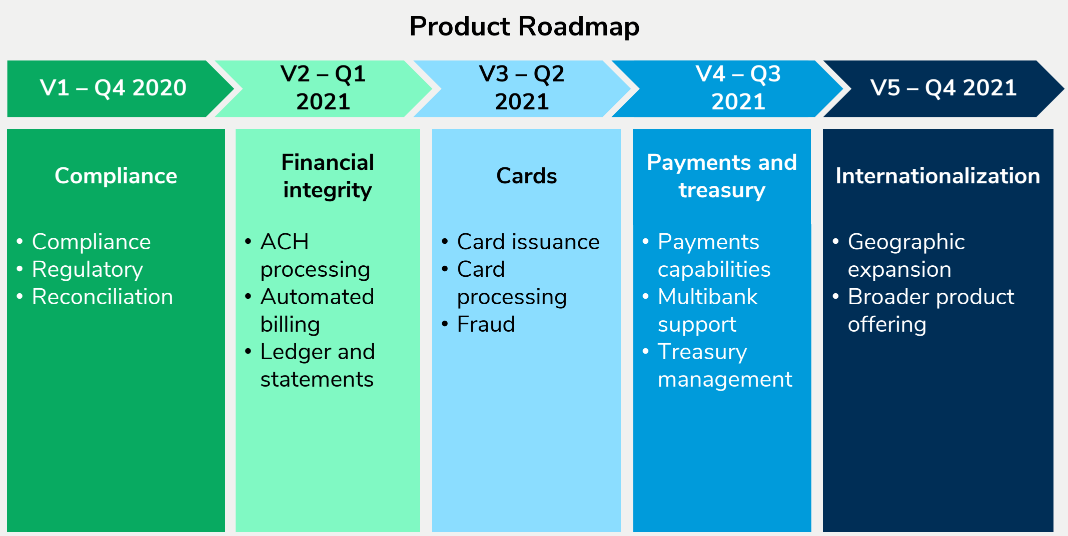


Source: Synctera

Synctera's product roadmap describes the path forward for this platform. Synctera plans to be able to service a wide range of needs for classic neobank or challenger bank fintech firms, remittance companies, and embedded finance use cases by fall 2021. Because the company is a new entrant into the marketplace, one test it faces is its ability to deliver product enhancements.

Beyond current enhancements, Synctera has an aggressive development schedule for expanded platform services Figure 8. Synctera is not alone in the platform business, however. Essentially, all platform providers are facing the same urgency.

FIGURE 8: SYNCTERA PRODUCT ROADMAP



Source: Synctera

SYNCTERA'S VALUE AS A MARKET-MAKER BETWEEN BANKS AND FINTECH FIRMS

Synctera's role in the value chain is not limited to its platform offering. The company is acting as a market-maker between banks and fintech firms to create new business for both. To achieve this, Synctera takes on the following additional tasks to support the fintech firms and banks:

- Actively engage with the fintech community to identify and work with fintech founders and established fintech firms to help them find a bank to work with.
- Create a match between banks and fintech firms. Fintech firms can reach multiple banks by partnering with Synctera and will not have to go door to door anymore to find a bank match. Banks will be supplied a steady stream of fintech firms matching the banks' preferences regarding fintech firms they would like to work with based on the banks' balance sheet capabilities, needs, specializations, and risk appetite.
- Execute due diligence on behalf of the banks based on the bank's risk parameters.
- Support fintech growth scenarios and changing needs.

To summarize, the role of Synctera is that of a service provider to both the sponsoring financial institution and the fintech firm, offering a full suite of services including IT development and support, compliance management, and match-making. Synctera's platform provides the following benefits and range of services as desired and selected by the sponsoring institution:

- Supervise the fintech firm's ongoing regulatory compliance
- Lower operational cost (e.g., by providing reconciliation and other operational services)
- Offer preconfigured services to the fintech firm based on the financial institution's risk parameters for those services
- Assist in finding and onboarding new fintech company relationships
- Provide guidance to fintech firms and the financial institution as a facilitator of the relationship

AAITE-NOVARICA GROUP'S TAKE ON SYNCTERA

Aite-Novarica Group has reviewed the platform and its current and future components. The architecture and concept design have been developed with a modern and thorough vision. The technologies employed are current leading technologies that should provide the internal functionality, external integration, and necessary performance to become a significant platform provider for financial institution/fintech firm partnerships.

Aite-Novarica Group sees the early focus on compliance services as advantageous in that many fintech firms focus on product features and intuitive customer experience functions, while partner institutions must meet innumerable regulatory and compliance elements. To the extent that any platform, including Synctera, can ensure regulatory issues do not arise, the value of that platform is enhanced.

In addition, an emphasis on compliance also sharpens the focus on security. The platform is encrypted end to end and has a variety of authentication methods and controls that enhance security.

From an attractiveness perspective, Synctera offers its services with both bundled and unbundled options. These are individualized from a contract perspective but integrated from a delivery perspective. This optionality provides both the financial institution and the fintech firm with a menu of services and costs, allowing the individual financial institution to deliver the service and realize the revenue growth.

Of course, the proof will be in execution over time. Given the size and magnitude of this undertaking, Synctera's success (or the success of any platform, for that matter) lies largely in its ability to deliver on its promises. This is especially true if, as expected, fintech firms continue to grow both in number and in range of services across all financial services industry verticals.

Synctera is well funded and expects to grow to 100 people by year's end to help build out its solutions. It is very possible that the platform will raise more funding in 2021 as momentum in the fintech marketplace continues to grow and as its products achieve more traction. The team, vision, and execution so far show a positive trend.

Synctera's approach can provide community banks with a low-risk entry into the fast-growing BaaS market, generating new revenue without large investments or long-term commitments. For fintech firms, the FaaS platform offers a growing set of essential services that supports neobanking and embedded finance. Adding Synctera's transparent business model and commitment to actively broker relationships between banks and fintech firms, it is clear that the company has a clear vision and robust value proposition. It is one of the players in this space to watch.

CASE STUDY: COASTAL COMMUNITY BANK

There is no better method to understanding how the financial institution/fintech firm opportunity can work and how a platform contributes to success than to review one bank's journey into the fintech marketplace.

THE BANK

Coastal Financial Corporation is a registered bank holding company of its subsidiary, CCB, which is a state-chartered commercial bank, Federal Reserve System state member bank, and a Federal Deposit Insurance Corporation (FDIC) member. CCB provides a full range of banking services to small and midsize businesses, professionals, and individuals throughout the greater Puget Sound, Washington, area through its 15 branches. The bank is headquartered in Everett, Washington. As of the end of 2020, total assets of the bank were US$1.77 billion.

As the focus of this research, the bank provides BaaS that allows broker-dealers and digital financial services partners (fintech firms) to provide banking services through their fintech offerings.

THE NEED

CCB began its journey to fintech relationships in 2015. The key drivers follow:

- The emerging threat from fintech firms to disintermediate traditional banking services
- The belief that refusing to partner with fintech firms could result in ceding significant market share over time
- The strategy of providing exceptional returns to stockholders as a community institution

The bank felt that the threat from fintech firms would continue to grow and that traditional banking, while not going away, would find itself outside a future mainstream line of business. Moreover, as the board and management considered the future of the bank, they believed that, as a small publicly held institution, the bank needed to outperform peers in both return-on-assets and growth. The board and management worked with external consulting firms to evaluate the bank's strengths and where the best opportunities could be found. Key areas of expertise and strong performance were identified in operations and compliance—two areas of need identified in the fintech space. CCB created an internal BaaS division called CCBX, the goal of which was to enable "broker-dealers and digital financial service providers to offer their clients banking services."[12]

Aspiration was CCBX's first fintech relationship. Aspiration is a Los Angeles-based broker-dealer. In entering the fintech business, Aspiration sought to offer combined savings and checking accounts to facilitate cash management for their customers. Once Aspiration was on board, and with evidence that the relationship was both working and profitable, CCB expanded the number of fintech firms it supported. Since then, CCB has continued to grow its CCBX division with both new business and investment in the human resources needed to support this emerging opportunity.

THE CHOICE

Having started its fintech partnership journey in 2015, CCB worked with fintech firms using mostly manual processes. But CCB knew that approach was not going to allow it to scale its financial institution/fintech lines of business. Amazon Web Services and Google each have more mature platforms, combining both cloud hosting and a growing menu of services. However, CCB believed that working with a startup such as Synctera would allow CCB to influence what the platform did and how it was designed, as well as build a technology roadmap that closely aligned with CCB's goals for growth and automation in its BaaS offering.

IMPLEMENTATION

As the Synctera platform continues to expand and add functionality, it will bring more automation to the financial institution/fintech relationships. Synctera provides data and messaging, workflow between the two business partners, and a single view of the data shared by the bank, the fintech company, and Synctera. The platform can be implemented with full KYC/CIP at onboarding and with other third-party solutions that address regulatory requirements, such as transaction monitoring for Bank Secrecy Act/anti-money laundering and OFAC compliance, unfair, deceptive, or abusive acts or

12. "Coastal Financial Corporation Announces Fourth Quarter and Year End 2020 Results," Coastal Financial Corporation, January 27, 2021, accessed July 2, 2021, https://ir.coastalbank.com/news-page/press-releases/news-details/2021/Coastal-Financial-Corporation-Announces-Fourth-Quarter-and-Year-End-2020-Results/default.aspx.

practices (UDAAP) compliance, and other disclosures (e.g., Truth in Lending Act). If the bank so desires, it may continue using its own legacy solutions.

Before Synctera, communication between CCBX and the fintech firm was by voice or email, or by using Slack. Synctera now provides that documentation and serves as a workflow engine between partners. The workflow removes duplication and misunderstanding, and has gates, steps, and traceable processes (audit trails) for audit and control. In short, Synctera provides the regulatory "journey" for the partnership. It also provides the security needed to allow each partner access to its own information and that which needs to be shared.

At the end of each day, batch files are created, and all information is available for review and approval by the bank and/or the fintech firm. Each day, the book of business from the fintech company is captured in Synctera, where it can be validated and onboarded to the bank as the BaaS sponsor.

As captured in the discussion on Synctera, the platform is expanding its functionality daily and is developing additional services to increase its value in automation and assurance for both the financial institution and the fintech company.

RESULTS

The bank considers its venture into fintech firms a success, both before and after launching Synctera. Since beginning the CCBX division, the bank has grown the number of fintech firms from two to 15, with additional fintech relationships in the pipeline as of this writing and with more to be added in 2021. Thus, CCB is taking BaaS well beyond the experimental stage and believes this will become a fully vested and growing market segment. While banking services may seem like old news, fintech firms offer unique user experiences and additional services that banks often do not emphasize. Among CCB's fintech relationships are a diverse set of service providers for which the bank is the BaaS partner. Here is a sample:

- **Aspiration Financial:** Broker-dealer offering cash management with an emphasis on environmental and social responsibility
- **Ellevest:** A money management and financial planning source for women
- **ONE:** Targeting middle-income money management and budgeting

- **Carta:** Equity and capital management, including capital call lending

THE VIEW FROM CCB'S PERSPECTIVE

CCB has enough aggregate experience in financial institution/fintech relationships to offer key insights to becoming a BaaS partner bank. Some of these observations follow:

- Per CCB, pressures on community banking are real and are not going to get better on their own.
- CCB will try to optimize its traditional banking business while expanding its financial institution/fintech business.
- CCB's CCBX division was launched with a vision of creating a new source of business that cuts across all of banking services but is delivered through fintech firms that offer unique, nonbanking value propositions. Success thus far has largely depended on CCBX's emphasis on the opportunities and its resource dedication to this market.
- Automation through a robust platform remains a key to scaling the financial institution/fintech business. This is especially true when considering that significant growth will result in millions of data points to manage. In some ways, BaaS providers will become data management companies.
- Despite the need for commitment, automation, and resource support, the true success of the relationship so far has been the trust CCB has established with its fintech partners—a key to ongoing success.

OTHER STRATEGIES

Two other financial institutions are discussed briefly below. They have two things in common with CCB. They have entered the financial institution/fintech marketplace as a strategic part of their business, and they are community banks, demonstrating the ability for smaller institutions to become BaaS vendors. At the same time, these institutions are unique in that they have taken different acquisition strategies to entering the financial institution/fintech market: acquiring a nonbank subsidiary and acquiring a specialty bank.

ACQUIRING A NONBANK SUBSIDIARY

MVB Financial Corporation is the holding company for MVB Bank, which is headquartered in Fairmont, West Virginia, with total assets of US$2.3 billion at the end of 2020. The bank has entered the financial institution/fintech line of business through the 2019 acquisition of Chartwell Compliance. MVB Bank's reporting discloses the following:

> Chartwell Compliance provides integrated regulatory compliance, state licensing, financial crimes prevention, and enterprise risk management services that include consulting, outsourcing, testing, and training solutions. Chartwell has expanded its services to both fintech clients and banks. The company is also involved in new innovative strategies to provide independent banking to corporate clients throughout the United States by leveraging recent investments in fintech. The dedicated fintech sales team is based in Salt Lake City, Utah, and specializes in providing banking services to corporate fintech clients, with an overarching focus on operational risk and compliance.

ACQUIRING A SPECIALTY BANK

Seacoast Banking Corporation of Florida is a financial holding company with its principal subsidiary, Seacoast National Bank, headquartered in Stuart, Florida, with assets totaling US$8.3 billion at the end of 2020. As part of its strategy, the bank bought First Green Bancorp Inc. in late 2018. First Green added nearly US$800 million in assets to Seacoast's balance sheet. First Green focused on environmentalism, and that was evident in both its facilities (with a platinum LEED rating) and its banking practices; it is recognized as one of the leaders in the green banking movement and named a "2013 Company with the Best Green Business Practices" in the Orlando Business Journal. As part of continuing the fintech concept, the bank brought on new board members with nonbanking experience and fostered a cultural change on how to run the business. It views this acquisition as a different way of thinking about how to get business.

AITE-NOVARICA GROUP'S TAKE ON PARTNER BANKING

The Synctera/CCB story demonstrates one way for traditional institutions to enter the fintech marketplace. This story is unique in that CCB, seeing a need for platform automation, became the catalyst for the creation of Synctera. This allows the bank to influence ongoing development of the Synctera platform, which will help focus the future functionality on automating financial institution/fintech firm relationships. The two additional examples demonstrate that an acquisition strategy can provide the skill sets and the intellectual capital to jumpstart the entry into fintech markets. All this is available to community financial institutions.

In nearly every Aite-Novarica Group financial services practice, evidence of financial institution/fintech partnerships reveals BaaS is a growing segment and an approach to partner with fintech firms rather than compete with them. Much of the partnering to date has been low key and without fanfare. That is changing, however, as the number of fintech firms continues to grow and the need for licensed, regulated banking services makes partnering with financial institutions attractive to those firms.

At the same time, and as discussed previously, more fintech firms are seeking banking charters, which threatens to make BaaS and partner financial institutions obsolete. Financial institutions across the industry should consider establishing a strategic objective around the fintech partnership to keep BaaS a compelling and relatively easy option for fintech firms, most of which will soon discover the complexity and cost of being a bank, especially in meeting compliance standards.

One thing is clear: The expansion in the number of fintech firms and their range of services will not slow down anytime soon. At the same time, fintech firms need not be viewed only as a threat. This is because Synctera and other platform providers will expand their capability to bring automation, integration, and true operational skills to bridge financial institution/fintech firm partnerships, enabling growth and bringing new wealth to both.

CONCLUSION

Through the discussion of one platform vendor and a community bank, this paper addresses the larger issue of the opportunity for financial institution/fintech firm partnerships, whereby both partners can obtain new business and new revenue. The conclusions drawn are simple and clear.

Case study results:

- CCB's story demonstrates that offering BaaS to fintech firms (as but one strategy) can be a viable line of business for any regulated financial institution, regardless of size.
- Because of its strategic approach and level of commitment, CCB demonstrated success in fintech partnering even before the availability of a platform or service provider to help automate and manage financial institution/fintech operations.
- Leveraging a platform allows for more automation, additional operational support, and the ability to scale the fintech business unit more efficiently.
- As an IT and operational services provider for financial institution/fintech firm partnerships, Synctera is on the right track to develop into a significant player in the growing platform space.
- Given that it's a new entrant into the API platform space and the fact that CCB was a catalyst in the formation of Synctera, the platform and its value proposition will continue to be focused on financial services, specializing in specific and valued services.

Broader implications:

- There is more than one approach for financial institutions to engage in the fintech market. Other banks have succeeded in various acquisition strategies, including acquiring consulting/service providers and specialty financial institutions, whether merged into the institution or as an independent subsidiary.
- Financial institution/fintech firm partnerships benefit from intermediating platforms that enable service automation and data integration between the institution and the fintech company.
- The financial services industry is seeing a surge of fintech firms across all verticals, and financial institutions should make an active investigation and strategic decision on whether to become a fintech partner.

ABOUT SYNCTERA

Synctera connects traditional banking operations with fintech innovations, tearing down barriers stifling healthy business—namely, a lack of regulatory oversight and limited solutions to complex processes, which slow down launches. Synctera offers a platform that provides a range of flexible features and services for different banking and fintech needs. Synctera can also help banks find a fintech firm that is a good match with the bank and onboard it quickly.

ABOUT AITE-NOVARICA GROUP

Aite-Novarica Group is an advisory firm providing mission-critical insights on technology, regulations, markets, and operations to hundreds of banks, payments providers, insurers, and securities firms as well as the technology and service providers supporting them. Our core values are independence, objectivity, curiosity, and a desire to help all participants in financial services create better, more effective strategies based on data, well-researched opinions, and proven best practices. Our experts provide actionable advice and prescriptive business guidance to our global client base.

CONTACT

Research and consulting services:
Aite-Novarica Group Sales
+1.617.338.6050
sales@aite-novarica.com

Press and conference inquiries:
Aite-Novarica Group PR
+1.617.398.5048
pr@aite-novarica.com

For all other inquiries, contact:
info@aite-novarica.com

Global headquarters:
280 Summer Street, 6th Floor
Boston, MA 02210
www.aite-novarica.com

AUTHOR INFORMATION

Ron van Wezel
+31.6.3629.6515
rvanwezel@aite-novarica.com

David Albertazzi
+1.617.398.5036
dalbertazzi@aite-novarica.com