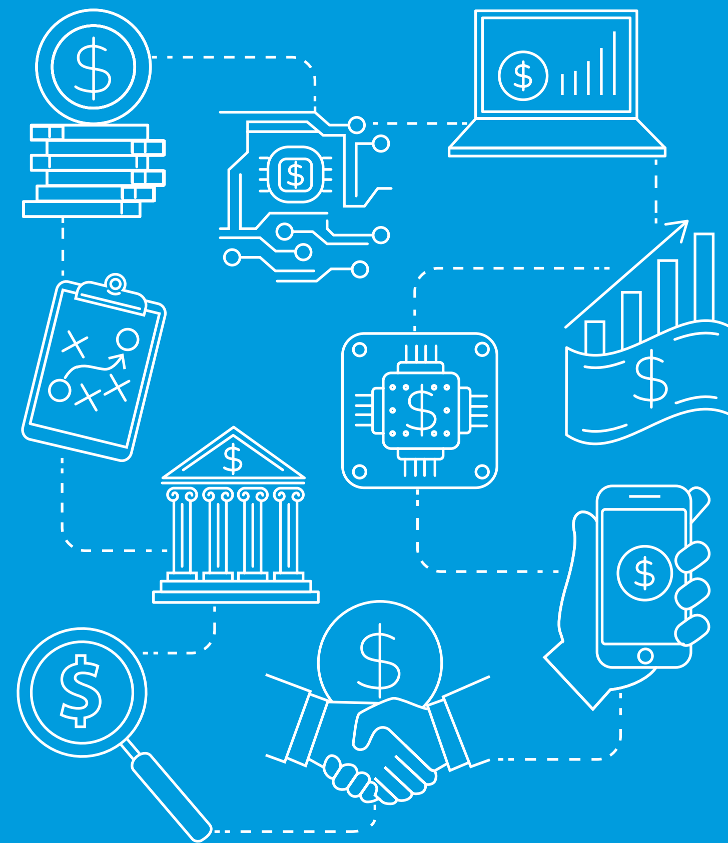
FINTECH AS A MOVEMENT

And how to build a road map for the path forward



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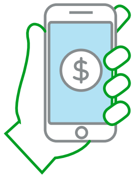
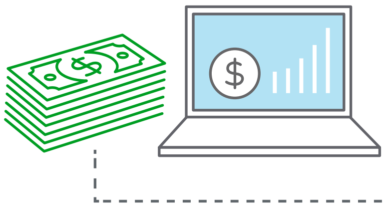
WHAT IS FINTECH AS A MOVEMENT?



Fintech has been disrupting the world of financial services for years, but it has evolved from a small number of innovators exploiting digital channels and technology to an entire movement fundamentally reshaping all sectors of the industry. Fintech companies leverage the power of technology, primarily via digital channels, to execute traditional financial services transactions and gain a deeper understanding of customers and their needs.

Fintech companies can blur lines, straddle definitions and compete with traditional institutions while sometimes operating in regulatory gray areas. The definition of fintech largely depends on the audience asked to define it, but typically refers to technology-driven solutions that execute a financial transaction via the digital channel.



There is **$100B invested globally in fintech today** compared to **$12.6 billion** in 2010, according to Pitchbook

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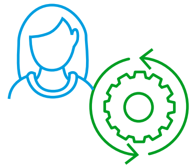
Common elements among fintech companies:

- Digitally native
- Developed to solve a specific problem
- Focused on a frictionless customer experience
- Historically have operated under limited and/or evolving regulatory oversight (but regulators are paying more attention as the space matures)

"When I think of what fintech companies are, they lead with technology to streamline processes in an effort to better serve their customers," says Nelly Montoya, RSM US financial services senior analyst. Simply having an app or chatbot, for instance, doesn't automatically make a business a fintech company, she says.

EMBRACING CHANGE

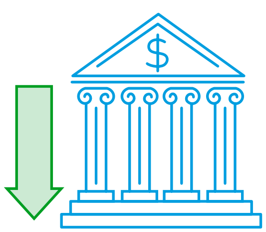


This fintech movement—the digital shift that is driving innovation in financial services as a whole—can also benefit more traditional financial services companies that are willing to adapt. Here are some key areas where traditional organizations may be able to glean lessons from fintech companies:

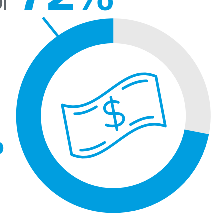
- Understanding and appealing to a shifting customer base, today and in the future
- Agility when it comes to technology investments
- Adopting a mindset that centers on innovation
- Exploring new pricing structures

> *"Fintech as a movement is the evolution that's occurring within the financial services industry," says Joe Kaczmarek, RSM US national fintech leader. "There's really a new infrastructure that's been created, and that's the platform that's taking the industry to the next generation."*

As consumers and businesses accelerate their migration to digital platforms for financial transactions, digital is no longer *a* channel—it is *the* channel for such services. The pandemic has hastened this digital transformation, and generational shifts will continue to accelerate it. Given the rapid pace of change in the industry, traditional financial services companies have to evolve in the context of this fintech movement if they want to avoid becoming obsolete.



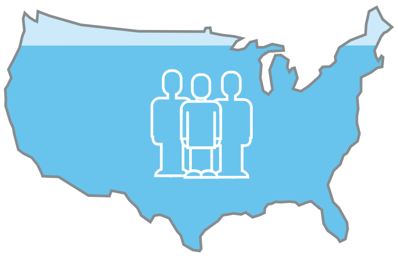
In October 2020, conventional banks accounted for **72%** of the **total market value of the global banking and payments industry,** down from **82%** in January 2020 and down from **96%** in 2010. (Source: The Economist)



> *"In 100 years, we'll still need the financial services products available today," says Montoya. "But how those services are provided—that's what changes."*

NEW TECHNOLOGIES

Technology and the emergence of financial services marketplaces have played a major role in increasing access to financial services; companies like Robinhood, Betterment and SoFi offer investing, saving, cryptocurrency, usage-based insurance and lending services to consumers previously neglected by existing industry players.



88% of U.S. consumers use fintech in 2021

compared with only **58% in 2020**.

(Source: Plaid)

Combine fintech companies' focus on a frictionless customer experience with changing millennial and Gen Z attitudes toward money and the result is a shift in consumer behaviors that challenges existing delivery and business models across all sectors of financial services.

Here are some key drivers of fintech disruption:

Artificial intelligence, data mining and machine learning: As a business tool, artificial intelligence can yield a significant competitive advantage. Machine learning, a subset of AI, is a technique to train computers to make decisions based on logical algorithms. Companies can use these technologies to better predict outcomes with the use of data.

Blockchain: A blockchain is a distributed, unalterable ledger system where transactions and information are verified by all participants maintaining and updating a copy of the ledger, rather than by one centralized authority. Blockchain networks are appealing because of their security, transparency, global scalability and their efficiency in building consensus among key stakeholders.

Digital assets: Cryptocurrencies, a subset of digital assets, are considered by many to be the future of money. Cryptocurrencies allow one user to transfer a "coin" to another using both encryption and blockchain technology in seconds. More than 1,100 cryptocurrencies are currently available; the best known is Bitcoin.

Strategic partnerships: As financial services companies look to expand their services digitally to remain competitive in the crowded marketplace, many have considered acquiring or partnering with existing fintech businesses to gain these sought-after, cutting-edge technologies.

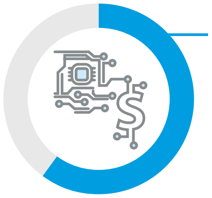
Companies that use data-driven insights, digital platforms and thoughtful strategies to prioritize the customer experience can differentiate themselves as innovators in the market.

BLURRED LINES

The term fintech has historically called up notions of technology-forward startups entering a space with legacy players and finding a niche there. But the landscape has changed; financial services companies today need to compete not just with such startups but also with major name brands in other industries launching finance products.

> *"When most people think about fintech, they think about startup companies disrupting the landscape of financial services," says Peter Brady, RSM US national financial services leader. "And while that's true, the bigger story is in how the landscape is responding to the fintech companies."*

Take Big Tech, for instance. Apple has its own credit card and Apple Pay; Amazon offers lines of credit to its merchants, and Google has expanded the offerings of its Google Pay function to include payment for services/goods, sending and receiving money, earning rewards and gaining insights into customers' financial health. These brands bring with them the advantage of already having customer trust, a host of touch points and the ability to curate the journey they want their customers to have.



60% of U.S. bank customers are willing to **try a financial product** from a tech firm they already use, and that number rises to **73%** for customers aged **18** to **34**.

(Source: CB Insights)

For more traditional financial organizations, that means their competitor base is significantly larger and leadership teams should expect disruption from a broader spectrum of competitors.

"It also means you can be much more creative in the way you deliver solutions; because, given the types of organizations you can partner with, the possibilities are limitless," says Chinyamutangira.

Only **43%** of banks believe they **effectively serve millennial customers** between **25** and **40** years old.

(Source: Bank Director)

> *"It's really blurring the lines and raises the question, 'Who is a financial services company and who is just a technology company?'," says RSM financial services senior analyst Kennedy Chinyamutangira.*

UNDERSTANDING REGULATION

The topic of regulation in the fintech space in some ways might feel like a Catch-22 ; many in the industry—at newer and longstanding organizations alike—desire regulatory clarity, but also worry that more regulation might hamper rapid innovation.

This is top of mind in heavily regulated sectors like banking and insurance along with emerging areas such as blockchain and cryptocurrencies. Financial services participants need to assess how their digital offerings must not only comply with existing guidance that applies to them but also evolve to meet future requirements and oversight.

Top regulatory issues to watch include the following:

Bank Secrecy Act and anti-money laundering compliance: Complying with AML rules is vital for companies operating in the financial services space, even if not all of their products and services are offered via the digital channel. Know-your-customer compliance—verifying a customer's identity and determining whether their financial dealings are legitimate before establishing a relationship with them—will continue to be crucial for financial services companies.

Digital assets and cryptocurrency: As federal regulators continue to assess and grapple with how to move forward with regulation of the digital asset and cryptocurrency space, some states have stepped in to fill the gap that resulted from accelerated adoption of such assets, with mixed results.

Accounting and taxes: There is a range of accounting and tax considerations financial services companies should consider, especially when it comes to reporting requirements, accounting treatments for complex and/or unusual transactions, tax incentives, and state and local tax filing requirements.

Resilience plans and cybersecurity costs: Given recent ransomware attacks and the heightened focus the pandemic has put on resiliency, we expect financial services organizations to continue to improve business continuity plans. This focus includes protecting customer information and developing resiliency plans that incorporate a Sheltered Harbor framework.

Some fintech companies may still operate on the edges of regulation, but evolving guidance from regulators can provide some insight into future requirements.

"One of the barriers to entry in the financial services industry is regulation," says John Behringer, RSM US national financial institutions sector leader. "This is an advantage to traditional firms as they compete against fintech, because they've got very strong, mature regulatory compliance programs. This provides a significant edge."

KEY ISSUES

The fintech movement has created vast opportunities in the financial services space for organizations that are ready to evolve. But there are still plenty of issues companies need to confront if they want to become truly digital-first businesses.

Data: The protection of personally identifiable information—or PII—has always been a hot issue in financial services, but organizations will need to be strategic about continually improving their data privacy protocols in an environment where more transactions are shifting to digital platforms, and cyberthreats are becoming more sophisticated.

Unintended bias: Companies that embark on developing data-driven approaches to new financial solutions need to be aware of unintended biases that may exist in the data they collect and use, and how to navigate those potential pitfalls.

Labor: Another major challenge is around recruiting and retaining talent. Given demographic shifts and changes accelerated by the pandemic, employees also have higher expectations for flexibility and choice of work location.

Identity and business model: Rather than focusing their business model around digitizing manual processes, companies need to understand how to create a truly digital business model.

> *"Companies need to ask themselves, 'How do I not become a commodity? How do I differentiate my products and offerings?'" says John Behringer, RSM US national financial institutions sector leader. "Because if your business becomes a commodity, all you can compete on is pricing and operational efficiency."*

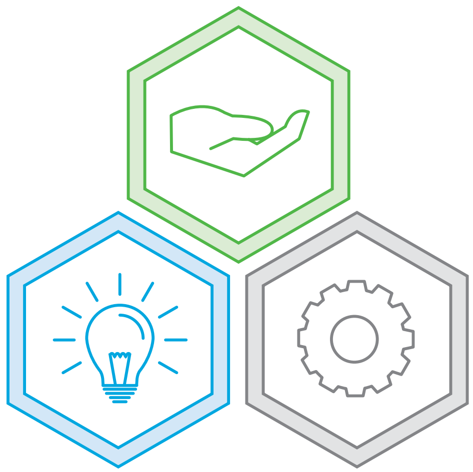
Financial services companies already have to go above and beyond to assure customers that their data is safe and that the company will communicate clearly when data breaches occur. As businesses integrate more functions that use AI and other technologies, customers need a basic understanding that the technology will work and that it doesn't introduce additional risks.

BREAKING DOWN DIGITAL DISRUPTION

Financial services companies need to understand how fintech—and Big Tech more broadly—is changing the game.

While most companies understand that they need to be more digital, leadership teams often aren't sure how to assess what that means. To make digital disruption more tangible and easier to understand, companies should think about how it relates to three key areas of the business—customer experience, innovation and intelligent automation.

Re-imagining your customer experience
Engaging with your customers how they want to and where they want to in an increasingly digitized journey supported by foundational capabilities in people, process and technology



Becoming an innovative organization
Changing the way your organization thinks and behaves to become more agile, creative and adaptive to changes in technology and the business environment

Using intelligent automation
Automating business processes and using data and machine learning to make better, faster and more efficient decisions

BREAKING DOWN DIGITAL DISRUPTION

Here are some key questions financial services company leadership teams should ask themselves to evaluate their organizations' current positions in the context of the fintech movement and digital disruption:

Re-imagining your customer experience

1. Is the company customer-focused? Does the company have customer-first, digital experiences that solve a problem, improve satisfaction and retain customers?
2. How does the company optimize the customer journey across multiple channels, preferences and throughout the life cycle?
3. How does the company use data to understand customers, enhance the experience and drive more business? Has the company considered using artificial intelligence and machine learning to increase efficiencies and improve the experience?
4. Do you have the right technology to enhance the customer and talent experience?
5. Has the company identified the skills its talent needs to execute a successful customer experience strategy?

Becoming a more innovative organization

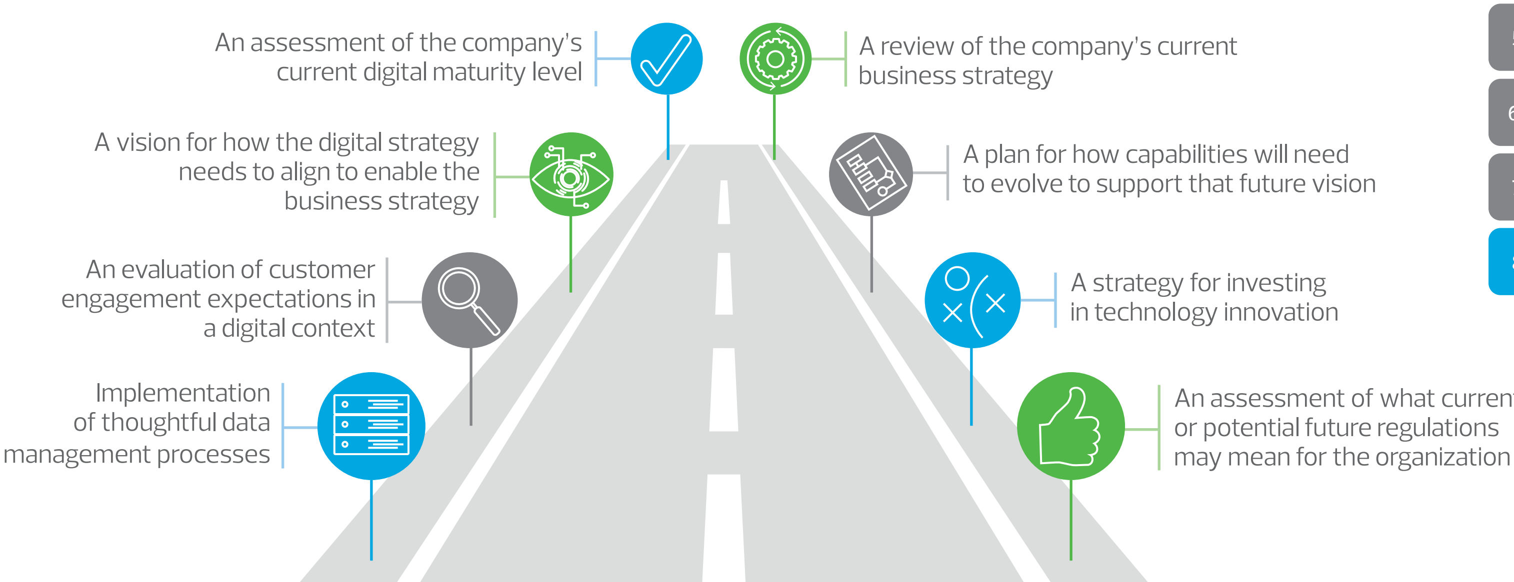
1. What problem (or problems) is the company looking to solve through innovation?
2. Is there a common vision across the company for what innovation looks like?
3. Does the company have a culture of innovation? How could it cultivate a more innovative culture, and what are the implications of cultural shifts for attracting talent and risk tolerance within the company?
4. Does the company have a model that supports innovation through entrepreneurial functions?
5. Does the company have a process for building, driving and testing ideas?
6. How much is the company willing to invest in innovative ideas, knowing some will win and some will lose?

Using intelligent automation

1. Has the company automated routine processes to create efficiencies, reduce labor costs and improve accuracy?
2. Has the company considered reengineering business processes, removing redundancies and eliminating errors?
3. Does the company have core legacy systems that need to be modernized through financial automation?
4. Has the company considered using machine learning to automate decision-making at scale?
5. Does the company utilize data analysis to gather better information from large data sets?

A ROAD MAP FOR THE PATH FORWARD

Traditional financial services institutions adapting to the changes fintech is spurring need to create a digital road map that includes the following:



The notion of fintech comprising one slice of financial services is a thing of the past. Institutions that want to remain competitive need to understand that the solution-oriented, tech-driven ethos of fintech now permeates every aspect of the industry.