The evolution of fintech and incumbent partnerships

A roadmap for collaboration between Canada's trusted financial service providers and the financial technology start-ups re-defining the consumer banking experience.

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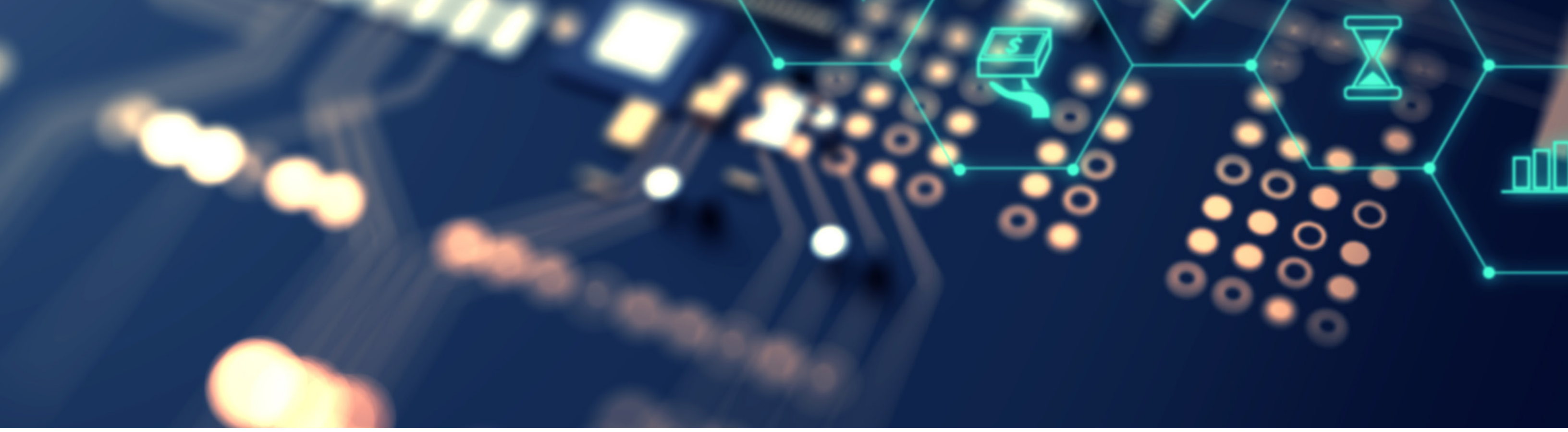


Introduction

An increasingly connected world is reshaping customer preferences. Consumers now expect innovation and seamless digital experiences across all sectors, from retail to banking. They expect even the most traditional services to be imbued with seamless and immersive digital-only user experiences. In response, the banking sector has seen a proliferation of financial technology (fintech) startups over the past decade. These changing preferences and expectations, coupled with the rise of fintech, are pressuring incumbent financial institutions to step up their innovation game.

Banking has historically been an insulated industry. Yet, technological advancements such as peer-to-peer (P2P) networks, application program interfaces (APIs), distributed ledgers, and the ubiquity of smartphones have enabled fintech companies to present a serious threat. For example, evolving open banking ecosystems today in jurisdictions such as Australia and England empower customers to share their financial data, held by banks, with trusted third parties.

As the Canadian financial sector moves toward a similar open banking framework, today's incumbents will undoubtedly pursue more partnerships with fintech to augment their respective product and service offerings. Financial institutions that can consistently anticipate and meet their customers' continuously evolving expectations and needs will have a distinct advantage over those that do not — and fintech will play a critical role in helping incumbents gain that advantage.

Yet, fintech and incumbent partnerships bring with them a unique set of challenges which both parties need to understand and overcome. MNP set out to investigate these inherent challenges by leveraging our experience as one of Canada's primary advisors to both the fintech community, as well as mid-market and large financial institutions.

Based on our research and discussions with clients, industry stakeholders, and academics, we highlight emerging trends and provide practical insights and recommendations for both fintech and incumbents to build successful partnerships on the road towards collaborative, customer-centric digital transformation.

"There will be opportunities for both incumbents and disruptors, but also a reenergized third framework where fintech will enable incumbents."

- Adam Felesky, CEO, Portag3 Ventures

The evolution of fintech and incumbent partnerships

Fintechs are often assumed to be a modern innovation, but they are by no means a recent phenomenon. Third-party technology ventures and partnerships have long been prevalent in financial services. What has changed is a new partnership model being deployed globally with smaller, more entrepreneurial fintech startups.

As fintech continue to emerge and mature, incumbents will need to adopt a strategic approach to collaboration and third-party relationships. We anticipate the most successful incumbents will partner with fintech in several specialty areas and deploy emerging technologies such as advanced data analytics and artificial intelligence to provide the meaningful experiences customers value and expect.

For financial incumbents, one of the more significant challenges is how to integrate smaller, more agile start-ups into their core operations. Cultural differences coupled with misalignments in governance, risk, and compliance often leads to extended integration timelines, unrealized objectives, and the erosion of deal value. To address these challenges, traditional financial institutions must transform their respective cultures; adapt their approaches to governance, risk, and compliance; and evolve their underlying technology architectures.

Perhaps the most important consideration for incumbents is an effective methodology for identifying and implementing third-party partnerships — in particular, with smaller startups. Adam Felesky, CEO of Portag3 Ventures, a leading Canadian fintech venture capital firm, told MNP fintech / incumbent partnerships will continue to be a key theme, but this won't be a winner-take-all category.

Impetus behind alliances and partnerships: Symbiotic relationships

Effective partnerships between Fintech and financial institutions can be highly symbiotic. Incumbents bring their extensive customer reach, rich data, and capital. fintech provide innovation, the potential for plug-and-play functionality, and augmented customer experiences.

Incumbents often lack the internal capabilities to enact digital transformation due to the significant compliance requirements, competing priorities to support the legacy business, and the need for cross-business-line, consensus-based decision making. While these challenges are real , they're increasingly dwarfed by the vast material benefits of partnering with fintech. We expect fintech / incumbent partnerships to accelerate as a result.

It's important to think of banking as a service, and ultimately what you could do to improve customer service. Integrating fintech is key in being able to offer better customer experiences and even target specific niches.
- Jan Christopher Arp, Founding Managing Partner, The Holt Xchange

Below is an overview discussing the impetus behind these types of alliances for both fintech and incumbents.

The motivation to partner: A fintech perspective

Regulatory compliance: Fintech can depend on incumbents to help navigate and facilitate compliance requirements in highly regulated environments such as retail banking and mortgages.
New customer acquisition channels: Incumbents provide fintech with a large, loyal client base as well as direct connectivity to their systems through APIs.
Consumer trust: Incumbents can help fintech improve brand recognition and attract new investors by providing consumer / institutional trust. This is especially true in Canada, where banks and traditional financial institutions are generally viewed quite favourably.
Low-cost funding / acquisitions: In many cases, fintech start-ups have been able to access funding through partnerships with financial institutions. Incumbents may look to acquire promising start-ups if partnerships are successful.
Learning and development: There is no better place for fintech to navigate the complex world of regulated financial institutions than within one. Insights and perspectives from industry experts can help enhance their respective solutions.
Shared services: Fintech can benefit from incumbents' marketing initiatives and reach. In acquisition scenarios, they can also utilize advanced people management practices and enterprise software platforms.

1. The motivation to partner: The view from incumbents

Modern brand elevation: Today's consumers demand frictionless, value-driven digital banking experiences. Fintech can help incumbents develop marketing strategies that elevate their respective brands and highlight their integrated capabilities and value propositions.
Innovative technology: Fintech offer innovative approaches to meeting customer needs, along with instant access to emerging and leading-edge technologies, significantly reducing the need for proprietary research and development (R&D).
Speed to market: Fintech enable established incumbents to become even more competitive by providing the user experiences customers have come to expect and value-added services, in an accelerated timeframe.
Serving new customer segments: Combining resources and brand power with fintech can help incumbents develop inroads with new and younger customer segments at a lower cost.They may even acquire customers in previously unaddressed or challenging market segments.
Access to top talent: In the ongoing battle for top talent, partnerships provide incumbents access to top engineers, data scientists, software developers, etc., they may otherwise be unable to attract.
Learning and development: Learning can improve both partners' positioning by addressing each parties' respective shortcomings, such as the incumbent's lack of knowledge surrounding evolving digital technologies and agile methodologies and a fintech's lack of knowledge or experience in regulatory compliance and bank decision-making.

Innovation models

Incumbent financial institutions have adopted several innovation models to develop technology solutions. These include combinations of in-house development through innovation hubs, partnerships, acquisitions, and outsourcing. Below is an overview of each model.

"[Financial institutions] need to have a very strategic mission, and then choose between build or buy."

- Elisabeth Laett, Managing Partner, The Holt Xchange

Build it in-house

Many financial institutions believe the most effective way to innovate is to address the opportunity internally. Canadian incumbents have largely adopted this internal model via 'digital factories' and even their own digital banks. Larger banks, in particular, have opted to develop their own proprietary technology. Examples include Scotiabank's *eHome* platform which digitizes the end-to-end mortgage process for homebuyers, and CIBC's Smart Balance Alert which uses advanced analytics to assess funds available against recurring or upcoming payments and alerts customers when their accounts may hold insufficient funds.

Canadian incumbents have also developed in-house accelerator programs and innovation hubs where start-ups can compete for funding and work at arm's length with the bank, to develop technology solutions. One example is RBC Ventures, which incubates both fintech and companies operating outside the financial sector.

These types of accelerators help start-ups integrate into the bank in a low-risk and controlled environment. While this strategy has suited incumbents with large innovation budgets, building technology products in-house requires sufficient resources with the right mix of skills. This strategy, however, is not a guarantee of success and presents an uncertain return on investment (ROI) for even the largest incumbents. While Canada's big banks have enjoyed relative success, their small and medium-sized counterparts, as well as Canada's credit unions, generally have less flexibility and capacity to fully adopt this model.

Partner or acquire

Given the costs, uncertainty, and other barriers along the in-house technology journey, many global banks have found success collaborating with fintech to develop innovative products, services, and customer experiences. Incumbents may acquire a fintech outright if the results of a partnership are favourable — or if there are strategic advantages in doing so.

We spoke with Jan Christopher Arp of the Holt Xchange, who sees advantages in incumbents partnering with fintech:

"Institutions can enhance their own capabilities by continuing to maintain a focus on what they do well, while integrating what the fintech do well."

There is a broad spectrum of partnering models used throughout the industry. Some of the most common approaches include:

1. **Vendor / client relationship:** The financial institution hosts a third-party technology solution institution or integrates it as a cloud-based software-as-a-service (SaaS) solution. This has traditionally been the most common approach in the financial services sector.

   Integrations between the third party and financial institutions is a longstanding challenge. However, this is being helped by the development of APIs and a push toward standardization or an open architecture model.

2. **White labelling and managed solutions:** Financial institutions may choose to outsource the management of certain products or services to a partner while presenting the service as its own brand. This 'white labelling' can be advantageous from a customer relationship perspective as the customer's experience is seamless and the third-party service fulfillment is invisible to the customer. An example might be a mobile small business lending solution funded and advertised by the bank yet managed by a third party.

3. **Mobile applications:** A fintech's technology is utilized to enable specific features or functions within a bank's mobile / digital ecosystem. Mobile applications are usually connected to online banking platforms or the bank's backend systems, providing the bank with a modern, omnichannel solution.

4. **Full outsourcing:** Areas that are not within the incumbent's core competency may be outsourced to a fintech partner or service provider. In this instance, there is a clear contractual division between the bank and the partner. Regulatory compliance monitoring and reporting are critical in this model.

5. **Application programming interfaces (APIs)** This model can work in both directions. Financial institutions can publish APIs which allow fintech to plug into the core IT infrastructure and integrate their technology solution (and vice versa). This plug-and-play functionality is a relatively straightforward partnership model and will become more common as banks and credit unions continue to implement common integration standards — and as the concepts of open banking /consumer-directed finance evolve in Canada.

6. **Acquire:** Financial institutions often acquire fintech companies, particularly when a fintech introduces a product or service that yields a positive ROI. While exit by acquisition is often the end game for many startups, fintech should ensure the deal aligns with their goals and stakeholder expectations.

Fintech adoption among Canadian incumbents

While global partnerships between fintech and incumbents have been numerous and largely successful, Canada has lagged other financial centers. A recent report revealed there are over 1,000 fintechs operating in Canada, yet the number of partnerships with financial institutions is significantly lower.[1] The study noted Canada's big banks may be increasing their engagement with fintech, but most are still focused on building their own products and digital experiences in-house.

Unlike other global fintech centers, Canadian banks enjoy high levels of consumer trust and a reputation for prudent management and risk aversion. Their brands are also closely tied to Canada's history and deeply woven into the nation's social fabric. The result has been a banking industry with a resilient business model and little pressure to innovate or drastically change.

Larger financial institutions still hold the vast majority of market share in Canada, but there is widespread recognition amongst incumbents that they will need to figure out how to work with early stage and smaller fintech if they wish to enhance service offerings and achieve their digital innovation goals. Incumbents have recognized the need to improve collaborative relationships. However, most fintechs still find incumbents cumbersome to work with and potentially disruptive to their business. This highlights an opportunity for incumbents to enhance their partnering processes and align it to their respective growth and innovation strategies.

The mid-market opportunity

While Canada's fintech story will undoubtedly feature the big banks, the role of smaller banks, insurers, and credit unions is less clear. Canada's mid-market financial institutions face many of the same pressures as larger incumbents, including legacy core banking systems, organizational silos, regulatory burden, and competition for talent. And they need to solve these problems without the seemingly endless innovation budgets of their larger peers. Mid-market incumbents are, by necessity, therefore more inclined to rely on partnerships with fintech companies. Canadian mid-market institutions, such as credit unions, can often be more agile in their decision making and have generally been highly receptive to partnering with fintech.

Canadian credit unions specifically have pursued partnerships with fintech as a strategy to offer value and innovation to their members. According to Rob Paterson, CEO of Alterna Savings and Credit Union, the big banks present certain barriers to fintech that can make partnerships difficult.

> *"The banks are stuck saying that technology solutions have to be home grown, and any agreement with outside providers gets hindered by hundreds of pages of legal documentation."*
>
> - Rob Paterson, CEO, Alterna Savings and Credit Union

Furthermore, Mr. Paterson notes "bank executives can sometimes view fintech as competition to their own internal departments, and hinder the ability to advance their own careers. At Alterna, we don't have that issue, and our strength is that we can partner with literally anyone, because we know we don't have the internal resources to accomplish what our members expect." While fintech understand these advantages, they can sometimes overlook the mid-market opportunity.

1 Geoff Zochodne. "Inside the power struggle between big banks and fintechs to modernize financial services," Financial Post, March 27, 2019. https://financialpost.com/technology/watch-out-big-banks-you-might-wake-up-one-day-and-be-blockbuster (Accessed: June 27, 2021)

Recommendations for fintech to successfully navigate partnerships

Despite the clear reasons for, and benefits of, collaboration between fintech and incumbents, many challenges still stand in the way of successful partnerships. We have developed a series of recommendations, based on our experience with both parties, to help address some of the most pressing collaboration challenges. This framework will help both incumbents and fintech improve partnership outcomes.

As a fintech, how can your organization become partnership ready?

1.	Understand the regulations and compliance standards relevant to your product / solution
2.	Understand financial institutions' internal cultures, values, and processes — including how they make decisions (and why)
3.	Find your champion
4.	Assess the alignment of your product / service to the incumbent's internal processes and needs
5.	Nail down the use case and sell the problem
6.	Participate in accelerators and collaboration networks that closely align to your value proposition
7.	Understand incumbents' technology architectures and develop an integration roadmap
8.	Be flexible, but don't overcompensate on your core product offering
9.	Protect yourself contractually and seek advice from external advisors
10.	Set yourself up for success

1. Understand the regulations and compliance standards relevant to your product / solution

An appreciation for the regulatory complexities within the financial services industry is an important component in any fintech's go-to-market strategy. Fintech must commit time and resources to understand the financial institution's complex regulatory requirements and be prepared to tactfully address those concerns as they inevitably arise.

"Many fintechs are excited to partner with us, only to later discover the enormous compliance requirements of a regulated entity. Our partners then need to really lean on us for knowledge related to regulatory compliance, CDIC insurance, fraud and (anti-money laundering)."

- Neal Oswald, COO, Concentra Bank

At MNP, we have seen many of our own fintech clients encounter partnership issues because they didn't fully appreciate the magnitude or complexity of legal / regulatory constraints. Savvy fintechs should strive to meet (or exceed) incumbent compliance requirements. Pay close attention to relevant requirements such as OSFI Guideline B-10 on outsourcing, the relevant provincial credit union regulatory guidance on third-party risk management, or any other specific criteria relevant to the product or jurisdiction in question.

2. Understand financial institutions' internal cultures, values and processes — including how they make decisions (and why)

For partnerships to succeed, fintechs must understand how financial institutions bring new products to market as well as the key priorities relative to their clients and with respect to risk.

"While the fintech CEO is usually a technologist, the bank CEO is almost always a risk manager."

- Graham Seel, industry expert

The technologist should strive to understand the mindset of the risk manager. Be prepared to provide tangible evidence that a technology solution will reduce costs, increase revenue, or automate back-office processes while mitigating risks. That last point must be especially salient. Many of our fintech clients have benefitted from hiring or engaging ex-bankers and other financial services professionals to help better understand the priorities and decision-making processes within incumbents.

3. Find your champion

Ben Harrison, Head of Partnerships and Policy at Portag3 Ventures, sat down with MNP to discuss fintech / incumbent partnerships among their many portfolio companies. Harrison always advises fintech to find a champion within the incumbent who can be an advocate. This person will connect the fintech with the right people and can help ensure the partnership is considered an organizational priority. While the champion may help the fintech make inroads within the incumbent, it's unlikely they will be the ultimate decision-maker.

Harrison recommends fintechs first seek to align with business leaders prior to engaging with incumbents' technology leaders. In most cases, he says the business leader will hold the trump card. Gaining alignment between business and technology is an important role of the fintech and a core driver of innovation-based partnerships. Harrison notes:

"…though there's no silver bullet for accelerating the corporate sales cycle, the better the fit between your solution and the corporate pain point, and the greater the level of engagement and buy-in from senior business leaders, the quicker the process will move."

- Ben Harrison, Head of Partnerships and Policy, Portag3 Ventures

4. Assess the alignment of your product / service to the incumbent's internal processes and needs

Incumbents have become increasingly demanding when it comes to their investment criteria. Conservative financial institutions want to see pitches that emphasize quality (not quantity), outline clear use cases, and check all the boxes from a regulatory, risk, and user experience perspectives. Failing to deliver clear, credible, roadmaps based on business needs is a recipe for delays which smaller fintechs can ill afford.

To best engage senior leadership, fintechs are encouraged to consolidate their propositions to one-page visual roadmaps with clear use cases and timelines. According to Portag3 Ventures, focusing on a specific use case provides a clear goal and demonstrates the value of the partnership. If a fintech is challenged in articulating a use case, it may indicate they have a solution in search of a business problem rather than a business problem that requires a solution. Use cases should clearly define the business benefit, the potential challenges, and clear benchmarks of success.

5. Nail down the use case and sell the problem

Fintechs must also articulate how their solutions solve specific business problems or helps financial institutions capitalize on market opportunities. Incumbents want to understand both what they can do with a product or solution and why they should deploy it. Confusion related to use cases and problem definition can often reduce the likelihood of partnering. Portag3 Ventures advises their portfolio companies to reframe their pitches from "here is what our product can do" to "this is what you can do with our product."

A complex list of features and functions can overwhelm an audience. Demonstrating the benefits through use cases brings tangibility to those benefits. Rather than stating capabilities such as utilizing AI, delivering insights or automating processes, Portag3 recommends fintech focus on tangible outcomes such as increasing revenues, acquiring new customers, or enhancing productivity.

6. Participate in accelerators and collaboration networks that closely align to your value proposition

The Fintech universe is expanding daily. Incumbents are finding it a challenge to remain current on market trends, fintech entrants, and the overall partnering ecosystem. This lack of awareness has, in part, been addressed through the proliferation of regional accelerators and collaboration networks. These entities serve an important role in bridging gaps between fintech and incumbents — they also allow fintech to pitch their solutions and seek out advice from industry experts. Incumbents are relying more frequently on these collaboration networks to familiarize themselves with the global fintech marketplace.

In Canada, the MaRS Discovery District, located in Toronto, supports more than 1,000 startups and dozens of fintech.[2] MaRS connects fintech with representatives from a wide range of Canadian incumbents including CIBC, Manulife, Sun Life Financial, and Interac. Montreal-based The Holt Xchange especially supports fintech, accelerating their growth and adoption. Some of the prominent fintech accelerators are highlighted below. These networks each bring their own unique approach, focus, and capabilities to members and participants:

2 https://www.marsdd.com/our-sectors/fintech/ (Accessed: June 27, 2021)

Accelerator Name	Location
MaRS Discovery District	Toronto
The Holt Xchange	Montreal
North Forge	Winnipeg
Fintech Cadence	Montreal
Station Fintech Montreal	Montreal
Cultivator (by Conexus)	Regina
Co. Labs	Saskatoon
Intuit Prosperity Accelerator w/ Highline Beta	Canada-wide
Plug and Play	Toronto, Silicon Valley, Chicago
Fintech Innovation Lab	New York City
QC Fintech	Charlotte, NC

7. Understand incumbents' technology architectures and develop an integration roadmap

An important consideration for fintechs readying themselves for partnerships is how to integrate into incumbents' complex technology stacks. While some core systems remain an integration challenge, industry participants are taking steps to support easier third-party integrations. For example, a number of Canadian credit unions have recently adopted a common API standard, providing fintechs with easy access to plugins for data and systems.[3] Understanding these types of developments can provide fintechs with critical insights to establish partnerships. However, they should also be mindful of the unique cybersecurity and privacy considerations unique to financial services and overcommunicate the measures they're taking to mitigate potential integration-related risks.

8. Be flexible, but don't overcompensate on your core product offering

Fintechs are advised to avoid the all-too-common trap of overpromising on their solution's customizability or making unrealistic concessions to incumbent partners. Most partnerships and most solutions will require some level of customization, but it's unreasonable to redesign its product beyond its strategic vision or strain and capabilities to meet unrealistic commitments. Overpromising product or service capabilities is also a red flag for incumbents. They will generally view a solution being pitched to them as "vapourware" (i.e., all hype and no substance) if it requires significant changes to fit the use case or address the business problem.

> *"If you want to evolve and become a successful product, there need to be firm guidelines on what the product is and what it isn't."*
> *- Stephen McDonald, CFO, TickTrade*

3 https://celero.ca/2020/10/21/celero-implements-iso-20022-standard-for-celero-xchange/ (Accessed: June 27, 2021)

9. Protect yourself contractually and seek advice from external advisors

Seek professional assistance and advice regarding key aspects of intellectual property protections, conflicts of interest, corporate / deal structuring and other key success factors before reaching out to incumbents. As noted, incumbents appreciate clear roadmaps, well-defined paths to profitability, and realistic ROI calculations. Fintech would be well-served to identify relevant performance metrics, key working objectives, mutually agreed outcomes, and clear accountabilities — capturing these in a contract or statement of work. The selection of advisors, setting of expectations, and defining the terms of engagement are critical success factors for any fintech seeking to partner with an incumbent.

10. Set yourself up for success

Neal Oswald, COO of Concentra Bank, says partnerships need to be executed in a defined period of time with the target outcome of delivering a minimum viable product (MVP). There needs to clear alignment on the mutual benefits of partnership up front, and management should be encouraged to deliver a fast yes or a fast no.

> *"This is why we have built out a pre-requisite framework for Concentra's prospective partners, and also why we have paid attention to our onboarding capabilities. We need to hear them articulate a strategic view of what they want from the partnership, and we need to be able to articulate that back to them or it simply won't work."*
>
> *- Neal Oswald, COO, Concentra Bank*

Neal also shared Concentra's five prerequisites for partnership success.

1. Strategic fit assessment /partner due diligence — culture, ethics, strengths and weaknesses, and deal logic
2. Clear communication about mutual objectives, business case, and value creation
3. Agreed implementation plan, or sequence of events to get to a plan
4. Agreed governance (standardized metrics and oversight) with defined roles, responsibilities, obligations, expectations, incentives, and key performance indicators (KPIs)
5. A mutual understanding of how to work with partners and relationship expectations

Elisabeth Laett, Managing Partner at The Holt Xchange says "fintechs need to work with banking institutions very strategically and patiently. Build, at minimum, a three-year vision together of what the new technology will look like when it is integrated and deployed."

Recommendations for financial institutions to successfully navigate fintech partnerships

Just as fintechs must be prepared for partnerships with financial institutions and have a deal-ready product when they walk in the room, incumbents must be prepared to shoulder the accountability to facilitate and execute on partnership success. Financial institutions are seeking to bolster their own technology or customer experience through fintech, and successful integration requires significant strategic focus and effort.

Partnerships with fintechs or start-ups often don't succeed. This, in part, is because financial institutions don't adequately prepare themselves to introduce novel — and possibly disruptive —technologies and processes. So how can financial institutions increase the probability of partnership success? The following six focus areas provide a helpful roadmap:

1. Prioritize partnering within your organization's strategic plan
2. Establish partnering as a core competency
3. Reassess risk management frameworks, including third-party risks
4. Use appropriate performance measurement KPIs
5. Become integration-ready,
6. Transform your organization's innovation culture

> **"Business leaders have to cut through the noise and be very focused on what their business problems really are, and then engage with fintech to try and solve those problems. It's important not to be distracted by a solution because it may look new, exciting or cutting edge."**
>
> - Tara McKeown, Chief Employee Experience Officer, Conexus Credit Union

1. Prioritize partnering within your organization's strategic plan

Fintech partnerships can be a major success factor for incumbents seeking to rapidly innovate. The challenge is many financial institutions have not built a partnering competency into their formal strategic plans or generally employ an opportunistic approach to partnerships. According to TD Bank CEO Bharat Masrani, "You can't just partner your way to relevance — there has to be an internal shift in the culture of the bank."[4] The fundamental question is, what cultural within a financial institution can improve partnership outcomes?

Understand what problems you want solved, and who is best to solve them

Fintechs must articulate how their product or service solves a problem. Financial institutions need to understand the fundamental problems within their organization or their customer proposition that need fixing. This starts with an organization-wide conversation regarding those aspects of their business that need help. Once business goals and gaps are outlined, the focus can quickly move to how technology solutions may help, and whether these solutions should remain proprietary versus or could be delivered by others.

This can be a difficult process for incumbents, particularly given the significant investments many have already made developing and extending internal capabilities. The question then shifts to whether this is a problem that should be solved internally or prioritized for rapid release to the market with third-party help. Once objectives are understood and assessed, a strategic partnering approach can be incorporated into strategic planning — along with a solution roadmap incorporating business imperatives, outcomes, technology options, and a third-party vendor approach.

Centralize partnership activities to drive consistency

Many financial institutions manage their relationships with third parties, including fintech, at the line-of-business level. While helpful in fostering business alignment, this approach can introduce additional third-party risk for financial institutions and their partner — and result in added complexity and decreased speed to market. One way of adapting the approach is designating core teams and leaders dedicated to investigating, approving, and managing third-party relationships. This centralized function should act as a center of excellence for partnerships which ensure fintech and other third parties can successfully integrate with the financial institution.

Jason Hendrichs, CEO of Alloy Labs, an American fintech accelerator for community banks, believes "what will be telling in 2021- is actually developing the muscles and the capabilities in partnering. It's all about a culture of execution and avoiding the 'we can't do this because of risk' mindset. COVID has proven we can do a lot."[5] Incumbents should be on the offense, proactively allocating individuals within the organization to assess the needs of its customers, the gaps in its products, and which partners can help them realize their strategy.

4 "The New Partnership Era Ft. Bharat Masrani, Noah Breslow, and Ryan McInerney," Bank Policy Institute, April 3, 2019. https://www.youtube.com/watch?v=c55bV5gcNHM (Accessed: June 27, 2021)
5 JP Nicols. "Episode 353: Murder Hornets, Firenados, and Your 2021 Strategic Plan," Provoke.fm, September 4, 2020. https://provoke.fm/episode-353-murder-hornets-firenados-and-your-2021-strategic-plan/ (Accessed: June 27, 2021)

Give the centralized function a leader with authority

A German study of the largest banks in Canada, France, Germany, and the United Kingdom, revealed banks are much more likely to form alliances with fintech when they employ a Chief Digital Officer (CDO). Banks with a CDO initiated between six-and ten-percent more alliances with fintech than those that did not.[6] The CDO can coordinate a dedicated third-party collaboration team which has broad visibility across the enterprise and sufficient authority to clear internal roadblocks, resolve interdepartmental conflicts, communicate with senior leadership, and maintain a focus on customer outcomes and overall value.

Use the centralized function to research and identify potential fintech partners

Rather than partnering with fintech on a strictly ad hoc or opportunistic basis, financial institutions should determine how a partnering strategy may facilitate or accelerate the broader organizational strategy and identify fintechs specializing in areas of strategic focus. In our experience working with financial institutions, proactive incumbents dedicate sufficient resources to researching the fintech ecosystem for both attractive opportunities and to better understand emerging trends.

Portag3 Ventures Head of Partnerships and Policy, Ben Harrison believes just staying on top of market developments and engaging with fintech requires a dedicated focus. “You don’t need a whole team but having one person or a small group whose job it is to engage with fintech and find partnership opportunities for the organization is really important. Too often we find this work is being done on the side of someone’s desk who has another full-time job.” According to Harrison, a great example is Scotiabank, which has found success with their own dedicated partnership group, having decided that fintech partnerships are important enough to warrant a focused and dedicated team.

> *“Having a few people who do this is quite useful, and this is not rocket science. It means having a few simple processes in place to keep track of important industry developments and market players, but also, having a formal way of assessing fintech and connecting them to the pain points within the business is essential.”*
>
> - Ben Harrison, Head of Partnerships and Policy, Portag3 Ventures

6 Hornuf, Lars; Klus, Milan F.; Lohwasser, Todor S.; Schwienbacher, Armin. “How Do Banks Interact with Fintechs?” Forms of Alliances and their Impact on Bank Value, CESifo Working Paper, No. 7170, Center for Economic Studies and ifo Institute (CESifo), Munich, July 2018. https://www.econstor.eu/bitstream/10419/185368/1/cesifo1_wp7170.pdf (Accessed: June 27, 2021)

2. Establish partnering as a core competency

Tara McKeown of Conexus Credit Union emphasizes the importance of contract negotiations and having clear conversations with the fintech from the outset, however direct and uncomfortable some of those might be. It is important incumbents assess how a partnership will impact their infrastructure early in the process to adequately address any barriers to a successful partnership.

Once the two parties start working together, internal obstacles and a lack of coordination by incumbents are among the most common barriers cited by fintechs regarding partnerships — largely because many incumbents lack formalized systems, business processes, or a defined path for fintech to navigate. Financial institutions are often still siloed, with each business unit or department making its own decisions on whether to buy, partner, or invest in a fintech.

> *"Serious commitment for change sometimes exists at the top levels and customer-facing levels, but it's important to motivate all the employees in the middle as well. Organizations should give employees a reason to step outside their comfort zone."*
>
> – Elisabeth Laett, Managing Partner, The Holt Xchange

A significant source of friction in partnerships arises when incumbents consider fintech as "just another vendor." Fintechs — especially early-stage companies — are not well-suited to be managed as a traditional vendor by incumbent organizations, who are accustomed to working with larger systems integrators and software providers. Fintechs have unique needs and limitations that should be addressed with an equally unique approach by incumbents. This requires flexibility and a higher level of upfront collaboration between the parties.

Helping fintech get 'bank ready'

Incumbents can help fintechs navigate their internal processes and systems and guide them through important considerations such as data security, regulatory compliance, and anti-money laundering requirements. As an example, banks employ discrete teams tasked with managing regulatory compliance, whereas smaller fintechs often lack the necessary resources to remain compliant. Fintechs simply may not have personnel with the skills and knowledge to effectively navigate complex regulatory issues or understand their impacts.

Above all, incumbents should foster a collaborative culture within their organizations, where employees have sufficient time, resources, and skills to work effectively with their fintech counterparts. This translates to providing adequate incentives related to partnership outcomes and encouraging engagement across the business for customer-centric innovation. As mentioned previously, many incumbents have helped fintech partners become 'bank ready' by developing their own internal accelerator programs that support early-stage fintech at an arm's length. These accelerators help prepare fintech to present their ideas to bank leaders, while simultaneously addressing important industry issues such as regulatory compliance, cybersecurity, and integration.

Mitigate protectionism and ditch the traditional vendor relationship model

One of the pain points we frequently hear from fintechs relates to barriers — both those that emerge when negotiating partnerships and those which remain in place once engaged by incumbents. Most standardized agreements and contracting processes among incumbents are developed with large vendors in mind. These can easily overwhelm smaller fintechs which often do not have in-house legal counsel.

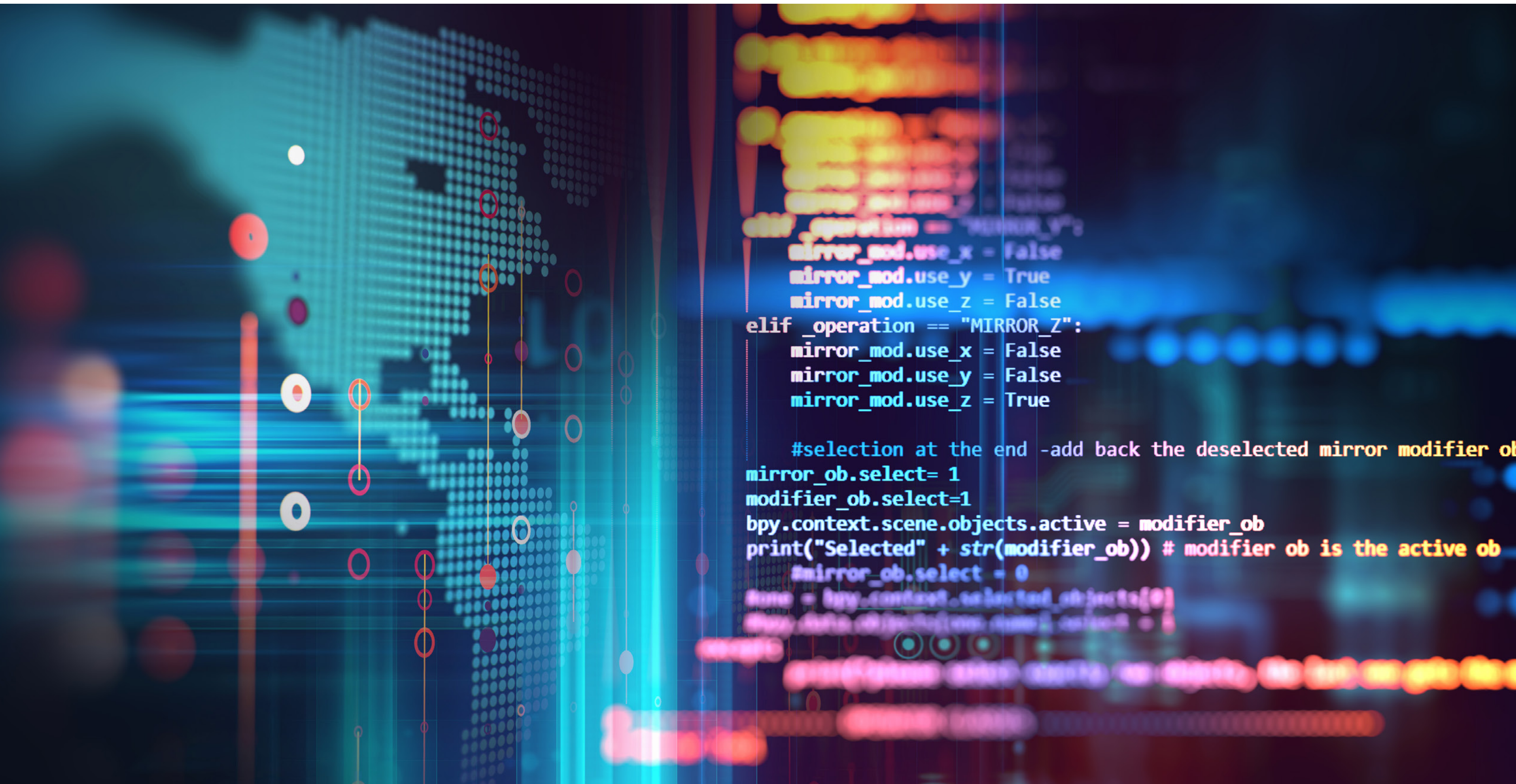
Incumbents should maintain adequate risk and vendor management policies; but, they should also seek to simplify their processes for smaller fintechs. What is standard practice for one can be immensely burdensome for the other. Alterna Savings CEO Rob Paterson believes incumbents should seek to minimize negotiation, and barriers to entry, and strive to get to the point of product launch.

> *"Don't try and dominate the fintech, don't think that you know it all, and remind yourself that you want to learn from them."*
>
> \- Rob Paterson, CEO, Alterna Savings

The importance of onboarding

Financial institutions should aim for standardized, well-defined, intuitive, and repeatable partnership processes. They should also look to Improve intake mechanisms and onboarding processes to help fintech partners navigate complex organizational structures and quickly connect with the right stakeholders. In addition, a culture of disciplined execution and accountability that focuses on deploying high-performing and referenceable fintech solutions can produce favourable outcomes. This requires leveraging technology solutions with the right internal processes and talent to facilitate and support successful delivery.

As an example, Concentra Bank has taken a deliberate and standardized approach to onboarding fintech partners. According to COO Neal Oswald, "Our goal is to be the fastest Schedule 1 bank to onboard partners so we can become a destination for the best fintech. We have a 'partnership prerequisites for success guide' that we put partners through to make sure we start off on the right foot. This guide covers important partnership components like KPIs, governance, and an implementation plan, and we try and get partners to agree to this beforehand to avoid issues early."



3. Reassess risk management frameworks, and adjust to incorporate third-party risks

Engaging in third-party relationships without appropriate risk controls can lead to poor outcomes for all stakeholders. It is critical incumbents understand and manage the risks stemming from fintech partnerships. With respect to risk management, an incumbent should consider where it can and cannot compromise.

Procurement and vendor selection processes have evolved somewhat to accommodate earlier stage companies, however overly complex or burdensome processes could still potentially discourage a fintech from pursuing a partnership. A comprehensive third-party risk management framework that includes partnerships with early-stage startups will address operational, reputational, contractual, regulatory compliance, and strategic risks associated with a potential fintech partnership. Other important and salient areas of risk include:

1. Data governance and ownership
2. Cyber security, data encryption, and privacy
3. Conduct and customer relationships
4. Skills and competencies
5. Third-party performance management
6. Legal risks

A formalized process of service level agreement development, execution, monitoring and management should be implemented to address these risks. This process should be captured within the financial institution's third-party risk management framework with policies and processes that clearly articulate key accountabilities across the lifecycle of the third-party relationship, including clearly defined governance, reporting, and communications policies.

Balancing risk with innovation

Fintechs often face lengthy approvals for their technology solutions when partnering with incumbents, who typically have entrenched risk-averse cultures which prioritize consensus-based decision making. Management and executives within financial institutions might reject a fintech solution if the perceived risk is too great.. The necessary risk lens can present as bottlenecks to agile fintech teams. Incumbent business and technology leaders must foster a collaborative approach with third parties to address these issues and remove the barriers to innovation. To do this while maintaining an appropriate appreciation for risk, financial institutions should:

- Utilize a practical cost-benefit approach to any partnership initiative, culminating in the development of a detailed business case. This should clearly articulate the risks, the cost profile, and the potential short to long-term benefits.
- Define a clear vision for the future state and the partnership's potential impacts on the organization and its customers, with a focus on outcomes — both intended and unintended.
- Directly link fintech partnerships into the broader organizational goals, including strategy, key initiatives and the enterprise's overarching product and service portfolios.

Empathize with fintech by understanding their sales cycle

While risk management is a crucial pillar in any third-party partnership strategy, incumbents should balance risk mitigation with pragmatism. Incumbents' internal processes, bureaucracies, and decision-making processes can often contradict the fast-fail approach common with fintech and other technology startups. Some incumbents have even conceded that risk management barriers have killed partnership deals with fintechs which are often operating on short timelines and thin margins. According to TickTrade CFO, Stephen McDonald, "a typical sales cycle with a bank is three to six months, and with security reviews and vendor management programs, the costs of closing a deal are very high."

By imposing longer sales and planning cycles by virtue of their own decision processes and policies, incumbents can inadvertently derail potentially high value partnerships.

> *"Some partnerships emerge serendipitously, and fintech come from the world of 'we want to get things going now.' They have the resources and the need to get revenue on the books, while the incumbent has their strategic plan and roadmap that has been put in place through a formal process and is generally inflexible to changes outside of the planning cycle."*
>
> \- Ben Harrison, Head of Partnerships and Policy, Portag3 Ventures

Incumbents should temper strategies with the understanding that risks should always be balanced with the potential rewards of increased customer satisfaction, calculable ROI and the appreciation of shareholder value. They should also build provisions into their strategic plans and roadmaps that allow flexibility for opportunities that arise on an ad hoc basis.

Finally, if a financial institution does decide to explore a fintech partnership, expectations surrounding process, timelines and decision criteria should be early and transparent to optimize participants' time and effort. It's critical that all parties have this information so they can allocate resources and work toward a common understanding of the process and desired outcomes.

4. Use appropriate performance measurement KPI's

One of the more significant issues that can hinder fintech / incumbent partnerships is a lack of appropriate performance metrics. Certainty is hard to come by, and establishing ROI for technology investments can be difficult in any industry. Financial institutions can also struggle to establish the quantitative versus qualitative benchmarks related to partnerships.

Both sides should agree, in advance, on appropriate KPIs, project objectives and accountabilities. According to industry expert Sam Kilmer, even when all of this is in place, the roadmap still requires a reality check: "Does the fintech have the resources to live up to the commitments it's making? On the flip side, does the financial institution have the resources, and more importantly the capacity to execute and actually implement things?"[7] Ambiguity when answering these questions can paralyze collaboration, investments, or acquisition decisions, and further hinder mutually beneficial partnerships.

Recommendations:

While financial institutions tend to prefer quantitative measures of success, our view is they should consider a complimentary longer-term, qualitative view of measuring partnership outcomes in additional to hard measures. Both incumbents and fintechs should monitor and report on quantitative and qualitative performance metrics to ensure continued alignment on scope and expectations — and for clarity on what is required from each party to sustain the partnership for the long-term. While defining quantitative metrics can be difficult, partnerships should adhere to a broad set of agreed performance measures specific to the partnership and aligned to organizational outcomes. Qualitative measures could include partner satisfaction, customer satisfaction, or net promoter scores. These should complement qualitative measures while aligning to the incumbent vision.

7 Steve Cocheo. "Making Fintech Partnerships Work: Tips for Banking Providers," The Financial Brand. https://thefinancialbrand.com/91651/fintech-partnership-digital-innovation-disruption-strategy/ (Accessed: June 27, 2021)

5. Become integration ready

Banking systems have become highly complex due to mergers, the introduction of new products and services, and an ever-evolving regulatory landscape. At the same time. legacy systems continue to limit what incumbents can do from an innovation perspective. Core banking systems, the workhorse of any financial institution, have long been stable and robust — and must be so to securely process millions of daily transactions. These systems, however, present costly challenges to incumbents and fintech alike: complexity and risk both to the financial institution seeking to innovate and barriers to fintechs accustomed to (or hopeful for) plug-and-play functionality.

"Any cloud-based future roadmap comes with a lot of interfaces, and if you don't have an ability to quickly and easily connect interfaces to each other, how are you ever going to take advantage of cloud-native software?"

– Leonard Hendricks former CTO of Celero Solutions.

As most financial institutions work towards opening up API gateways for third parties, and implementing common integration standards, fintechs still face a fundamentally closed architecture, especially to core banking systems. According to Tick Trade CFO Stephen McDonald, one of the biggest challenges from a contracting point of view is a fundamental lack of understanding around the technology stack. "The software being used in the typical incumbent is very complex, and when you start a project you don't always know all of the details. What can happen is you sign a contract, and then there are 100 change requests because of unexpected integration challenges, which can make things very time consuming, and expensive."

While fintechs seek access to back-end systems and data sets, the inclination to employ shortcuts can be problematic. Incumbents should ensure any third parties being engaged adhere to strict cybersecurity, privacy, and data standards. For example, if a backdoor or weakness exposes a financial institution to a breach of its customer data — its data crown jewels — the potential costs, both financially and reputationally, would far outweigh any potential benefit of a fintech partnership.

What matters most to fintechs is that banking systems have provisions for collaboration. While integrating with core systems remains a challenge, potential open banking legislation may introduce requirements for banks to expose APIs to qualified third parties and serve as an accelerator for migration to an open architecture approach. The Canadian credit union system has gradually transitioned to a common integration standard, which has been lauded as a strong first step toward helping fintech integrate into core banking or other legacy platforms.

Recommendation

Financial institutions will require foundational investments in making their data easily available to third parties to differentiate themselves from intensifying competition. This means developing, testing and maintaining API libraries, so they are available and reusable by qualified third parties. Concentra Bank COO Neal Oswald says "we spend a lot of time thinking about API library management and strategic use of APIs. We also try to make sure that our IT systems utilize a microservices architecture that is component and capability-based, so we can assemble the client journey. Fintech understand this but they are the front end. As a bank, you need to make this happen end-to-end, which means a lot of design and implementation."

Making data available strategically to third-party innovators can help financial institutions accelerate innovation and build the pathway to improved customer experiences — something closed architecture and older legacy systems inhibit.

6. Transform your organization’s innovation culture

Canadian financial institutions are evolving. With the challenges presented by COVID-19 pandemic, they have accelerated change to adapt to a dynamic market. They have adopted digital first strategies to better serve customers and are promoting agile work cultures that foster collaboration amongst teams. Much of this was in play prior to the pandemic, with a growing push to keep pace with digital trends. But incumbents have largely adopted these strategies out of necessity, responding to changes in consumer behaviours, such as physical distancing and stay-at-home advisories. But what does this mean for fintech partnerships? To continue transforming both what and how they are serving customers, financial institutions must go further in fostering innovation by implementing an agile execution culture.

Speaking to MNP about the importance of organizational culture in helping a partnership succeed, Tara McKeown of Conexus Credit Union said “You have to watch for how much is going to change as a result of a partnership with a fintech and the ability to adapt to that change within the organization.”

Agile methodologies make it possible to learn on the fly, saving time and money. With agile teams, there is empowerment to co-own a solution with a third party from end-to-end, providing incumbent / fintech teams with cohesiveness and a single voice, as both parties have a stake in shared outcomes. In MNP’s experience as system implementers, agile projects introduce new products and services more quickly and efficiently. Incumbents wishing to succeed in the race towards digital and in facilitating highly effective partnerships with fintech should extend these concepts beyond their traditional IT domain, and embrace agile execution culture as a strategic priority.

Fintechs are inherently agile organizations, with most naturally embracing the core tenets of agile:

1. **Innovation** – focusing on the unique fit of each solution rather than following rigid processes or standards
2. **Rapid value creation** – bringing iterative solutions to customers at pace
3. **Flexibility** – embracing change as a means to improve
4. **Collaboration** – engaging in frequent and open communication

Incumbents are certainly adopting agile, and it is critical to incorporate these principles toward fintech partnering. While most incumbent leaders understand existing processes, systems, and organizational structures may present obstacles to delivering agile projects, they are less certain of how to effectively instill an agile execution culture within partnerships and, more broadly, throughout their respective organizations.

> *“A startup culture is one of innovation and being ‘customer first,’ which can actually be good if embraced by larger organizations from the top and then filtered throughout the organization.”*
>
> \- Jan Christopher Arp, The Holt Xchange

How to foster an agile execution culture

Three important steps can help foster both an agile culture and an environment where fintech are increasingly embraced as integrated team members : (1) Acknowledging the need; (2) developing the strategy; and (3) adopting best practices.

It's imperative incumbents clearly define their vision, identify the internal impediments to adopting agile within their potential partnerships, and create a transformation roadmap to overcome these obstacles. When implementing an agile execution culture, it is best to start incrementally — either within a line of business, or with a well-defined technology project — and then progressively scale through other areas of the organization. The fintech / incumbent partnership offers a unique opportunity to integrate these concepts and test against outcomes.

Acknowledge the need - and get stakeholders on board

Incumbents will encounter some familiar problems when attempting to deploy agile methodologies. A lack of a common vision (why agile?) and / or a lack of consensus on what it means to adopt an agile way of working leads many to fall short of the business value they anticipated. A pragmatic change management strategy can help address these issues — especially one adequately supported by appropriate resources and qualified agile practitioners at the forefront. Agile works best when it's supported by a leadership strategy that engages stakeholders, and clearly communicates the vision and benefits of the strategy. For executives, this means empowering employees, executing frequent touchpoints with teams, and identifying and resolving issues in real time. How employees view the partnership is critical to its success.

> *"Organizations need to build a spirit of embracing what this fintech partnership can do for the end customer and the value it can add — and let that be an anchor for employees. To do that successfully, organizations need to build a culture of psychological safety within the organization where employees don't feel their status, certainty or autonomy is being threatened by the change."*
>
> - Tara McKeown, Chief Employee Experience Officer, Conexus Credit Union

Develop the strategy

Implementing agile at scale requires integrating workstreams and rethinking how technology is developed, tested, and released. Incumbents should focus on creating a work cultures conducive to innovation and collaboration — both internally and with third parties. Friction often occurs when third parties impose an agile approach that conflicts with an organization's existing methods of developing and deploying technology solutions. Large-scale transformations are difficult. They require total commitment from leadership, a culture that's receptive to change, and the support of experienced agile practitioners who are able to effectively lead teams and sustain the newly adopted practices.

Adopt a culture of continuous delivery

A company's technology foundation is also critical to optimizing agile teams. Leading agile practitioners adopt software development and IT operations strategies that automatically release new features soon after the team develops them, flipping older and slower software development and IT models on their head. This method empowers proponents to collect timely feedback from customers about new digital products and services. It also serves as an important conduit between the lines of business and IT stakeholders.

Conclusion

Fintech companies will continue to drive financial services modernization and innovation. They will help shape consumer and business expectations and force incumbent financial institutions to adapt to these heightened expectations and the resulting competitive forces. While many industry observers have commented on the perceived “us versus them” mentality between fintechs and incumbents, it is our belief effective collaboration between both parties can accelerate progress and innovation in the sector for the benefit of all stakeholders.

To advance collaboration, financial institutions and fintechs must enter the arena with an open mind, understand the drivers of success for both parties and accommodate each other to support, rather than hinder, innovation and transformation. By recognizing the mutual benefits for partnerships, incumbents and fintech are more likely to thrive in the rapidly evolving financial services ecosystem. With ongoing regulatory reforms in Canada coupled with the changes in customer needs, combined with the rapid evolution of technology, the possibilities for fintech / incumbent partnerships seem endless.

About MNP

MNP is a leading national accounting, tax and business consulting firm in Canada. We proudly serve and respond to the needs of our clients in the public, private and not-for-profit sectors. Through partner-led engagements, we provide a collaborative, cost-effective approach to doing business and personalized strategies to help organizations succeed across the country and around the world.

For a deeper conversation on finding the right partner or making your partnership a success, please contact

Annette Bester, CPA, CA
National Credit Union Leader
306.664.8327
annette.bester@mnp.ca

Steven Luckie
Financial Services Institutions Leader
416.515.3837
steven.luckie@mnp.ca

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