Let's Talk About Risk

Whether you are new to the Fintech space or have been around a while, and whether you are a Fintech or a Bank working with Fintechs, risk is an inescapable part of the financial services landscape.

When assessing risk, the first thing to consider is your own risk appetite: are you comfortable working in industries with higher risk, or do you want to stick to more traditionally low-risk products?

Whatever the case, there are many types of risk to consider.

Fintech model risk - Direct/For Benefit Of ("FBO") vs Banking as a Service ("BaaS"). Regulators have been paying close attention to BaaS programs, in part because of recent BaaS model failures. BaaS models can result in Banks having limited oversight into their Fintech program accounts. This in turn results in loss of control. At the end of the day, the buck stops with the Bank, so understanding the industries their partner Fintechs are working within and having a clear view of their accounts and compliance programs is critical. The aim, before committing yourself, is to know the pros, cons, and rationale behind the model(s) you will pursue. If you are already in market and you don't feel you have a good grasp of this, now is the time to figure it out.

Program risk - Are you considering debit; credit; prepaid; lending; exception type programs like cannabis, gaming or crypto; direct-to-consumers (DTC); business-to-business (B2B); in country only; cross border? When assessing the type(s) of business you want to get into, dive deeper into the possible types of services and features. Decisions should include choosing programs and products that align with your:

- current business lines, as appropriate
- ethos and values
- risk appetite, which includes the risk appetite of your Issuing Bank Partner if you're a Fintech
- existing partnerships, alliances, and technology where possible
- products and services and how they align with the market and regulatory environment

Competition risk - Who are your competitors? Is the market crowded? Is there space for you? Consider factors such as:

- preferred geographic region
- competitor asset size
- competitor supported products
- the number of years your competitors have been in the market
- what they are doing well and what they are doing poorly
- what your competitive advantage is

Regulatory risk - Whether you are a Bank or a Fintech partnering with a Bank, the Bank's license, reputation, legal and financial wellbeing are at stake. Make sure you:

- understand and have implemented an adequate oversight model
- create and maintain strong regulatory policies and procedures

- manage suspicious and unusual activity to minimize AML/CTF risks and fraud losses
- have a calculated and thorough approach to compliance with consumer protection laws and regulations in mind
- ensure that the data exchanged among the parties and vendors is fresh and sufficient for regulatory reporting

Implementation risk - There is a lot for both Banks and Fintechs to understand and agree to. A sample of these are listed below:
- technical build out
- managing data (data governance, integrity and quality of data, systems architecture)
- staffing requirements - key team members and departments. This is critical for both the Bank and the Fintech
- expectation strategies for ramping up

Cybersecurity risk - All Fintechs face cyber security attacks and fraud attempts, some of which will be successful no matter how good you think your tools and processes are. A Fintech should never launch without:
- a well thought out and thoroughly tested KYC/KYB onboarding program, and fully integrated AML/CFT and fraud mitigation tools
- a strong vendor due diligence program. Remember, any use of third-party vendors leaves a program vulnerable to third-party software failures
- Invest in secure by design system implementations and data flows

Legal risk - You will need a legal team or outside counsel that is familiar with the line(s) of business you are pursuing and the oversight required. Do you:
- know the potential losses that can be caused by your client(s) and/or third-party vendors?
- have a plan for managing customer complaints?
- have strong contracts in place?
- meet all of your legal responsibilities?
- have an understanding of the laws and regulations of all countries you plan to operate in?

Operational risk - There are many things that can potentially disrupt your operations, both internally and externally. Luckily, we have noted just a few below to get you started on that 3am list
- do you have a disaster recovery / business continuity plan in place?
- do you have a strong vendor due diligence program for selection and approval of your third-party partners?
- do you have a compliance training program in place for your employees?
- do you have adequate checks and balances internally to avoid both intentional and unintentional violations and losses?
- is your record keeping adequate and accurate?

Financial risk - As with operational risk, financial risks are both internal and external. For example, you should understand:
- how a Fintech's assets and liabilities impact both its and the Bank's balance sheet
- what the revenue vs. expense model will look like
- the percentage of the Bank's balance sheet the Fintech will "own" (no Fintech should

total a large enough percentage that their leaving would put the Bank's financial wellbeing at risk)
- how to follow what is happening with federal policy and interest rates

Customer service risk - We all want our customers to have a great experience, but this can come at a cost. The easier you make it for your customers to onboard, move around, and withdraw money, the easier it is for fraudsters to take advantage of those same features. Some friction is necessary to help ensure bad actors stay out while at the same time there is a need to make sure there is not so much friction that legitimate clients give up becoming and staying a customer.

Reputational risk - Make sure you understand the level of reputational risk a Fintech brings to its Issuing Bank Partner and to itself. Do you understand:
- the customer base (i.e. millennials are more likely to make their complaints known to the public)
- the marketing method(s) to be used (i.e. websites, influencers, social media)

Additionally, Fintechs will want to consider the reputation of their partner Bank:
- has the Bank received any recent consent orders?
- could the Bank's reputation reflect poorly on the Fintech?
- how likely is it that it could fail or be shut down?

Opportunity risk - What *aren't* you doing in order to pursue becoming a Fintech or an Issuing Bank Partner?
- income opportunities (interest income, non-interest income)
- expense obligations (i.e. staffing, technology needs, etc)

Check in next week for more on managing your risks through good oversight.

This is the first in a series of collaborative articles written by iLEX Consulting Group, LLC and iDENTIFY.

About iLEX Since 2012, iLEX Group LLC has been a leader in delivering expertise in the FinTech industry, with a robust background in compliance, operations, and client management. We bring our client's visions to life with our ingenuity, partners, resources, and leadership.

About iDENTIFY iDENTIFY has become a leading fintech software company that provides banks with the tools necessary to unify their customer data. With several years of providing solutions for the banking industry, our vision is to streamline internal operations, create convenience for our clients, and give banks faster-to-market solutions.