Now Is the Time to Consider BaaS

payments fintechs digital banking

Summary: Challenging economic conditions coupled with the boom in embedded finance mean that BaaS is an attractive opportunity for CFIs seeking growth. We look at the BaaS market, various key success factors, and how some CFIs are capitalizing on this opportunity.

Did you know that ostriches and zebras work together to protect themselves and each other from predators? Zebras have excellent eyesight but a poor sense of smell, while ostriches are the exact opposite. This means that by combining forces, they can greatly enhance their ability to detect danger. This symbiotic relationship is not too different from a thriving business partnership, such as one at the heart of a banking-as-a-service (BaaS) offering.

With the current economic headwinds hampering community financial institutions' (CFI) growth prospects, now may be the time to embrace the opportunities offered by BaaS. BaaS, a business model in which a financial institution (FI) leverages its charter and capabilities to partner with a fintech or other business to provide financial services to the partner's customer base, is increasing in popularity. This popularity is being driven by growing consumer demand for an end-to-end experience — one in which financial products are seamlessly embedded in a non-financial customer journey. Essentially, BaaS can help CFIs acquire new customers at low cost — between $5 and $35 per customer, as opposed to $100 to $200, according to research by Oliver Wyman.

A $25B Opportunity

Cornerstone Advisors estimates that the value of the BaaS market will reach $25B by 2026, with around 300 FIs offering the service.

In 2020, venture capitalists Andreesen Horowitz counted 16 FIs with between $1B and $10B in assets, and 13 FIs with less than $1B in assets, to have entered the market, with an average of six partners. Today, it is thought the number of so-called partner banks is approximately 90. They are offering services ranging from credit or debit cards to savings, deposits, checking, and lending. These early adopters have demonstrated greater returns than the banking industry average.

Key Success Factors

If your institution is thinking of embarking on a BaaS journey, these **five factors may help ensure a successful outcome.**

1. **Complete alignment throughout the organization.** As with any strategic project, BaaS needs to be championed from the top down. Owners, the board of directors, and management all need to be aligned on the institution's BaaS strategy to ensure a successful implementation.
2. **Strong fit between partner bank and fintech.** CFIs should have a clear understanding of their target market and seek a fintech partner who is aligned in terms of the institution's capabilities, risk tolerance, and end customer profile.

3. **Sound relationship with the regulator.** Given the increased scrutiny of all fintech partnerships, a good relationship with the relevant regulators is key to identifying potential hurdles in time. You can read more about the regulators' guidance on conducting due diligence on potential partnerships in a previous BID article.
4. **Flexible technology.** A fully scalable, API-based technology platform is key to securing a partnership that stands the test of time. While many early adopters built their own, new entrants are more likely to benefit from partnering with one of the many BaaS platform providers now available, such as Nimbus, Treasury Prime, and Synctera.
5. **High security.** As third-party partnerships expose CFIs to another layer of cybersecurity risk, it is essential to have robust processes and technologies in place to ensure your valuable customer data is safe.

CFIs Successfully Embracing BaaS

A WA-based CFI with $2.6B in assets launched its BaaS solution in 2015. It now has 27 fintech partners offering debit and credit cards, lending products, deposit services, compliance oversight, and more. As an early adopter, the CFI developed its own technology, but as the program scaled, it became apparent that it needed a partner to manage operational and compliance aspects of the relationship. *"[Selecting a BaaS platform] has allowed us to focus our energy on serving our core market by helping us with partner management,"* says the President and CEO.

Another CFI, with $1.7B in assets based in VA, has taken a different approach. With some years of BaaS experience, it decided to rethink its offering by building its own scalable fintech platform. For increased security, its cloud-native architecture integrates *"a ledger, customer identification, transactional fraud monitoring, BSA and AML monitoring, ACH account identification, report writing and an integrated complaint management system."* The CEO notes that *"One of the key problems we've seen until now is partnering with a fintech company only to find that, once operational, they changed their focus, potentially adding significantly to their risk profile."* They're confident that taking full control of their BaaS solution will offer a best-in-class solution.

By embedding their BaaS offerings in third-party applications, CFIs stand to gain significant revenue. The key is to select the right fintech and technology partners. As well as gaining access to new markets, investing in these relationships will enable CFIs to improve their technology infrastructure and risk management functions — a win for both their new and existing customer base.

ECONOMY & RATES

Rates As Of: 01/11/2023 07:08AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	4.73	0.31	0.31
6M	4.85	0.09	0.09
1Y	4.71	0.01	0.01
2Y	4.24	-0.19	-0.19
5Y	3.69	-0.31	-0.31

10Y	3.57	-0.31	-0.31
30Y	3.69	-0.27	-0.27

FF Market	**FF Disc**	**IORB**
4.33	4.50	4.40
SOFR	**Prime**	**OBFR**
4.31	7.50	4.32