2023 in Review, Pt. 2 of 2: Challenges and Opportunities

cyber security   regulatory   industry update   fintechs   neobanks

Summary: In this second part of our review of 2023, we look at the challenges brought about by the evolving fintech landscape, the ever-increasing cybersecurity threats, and mounting regulatory complexity. We explore how CFIs have responded to these situations.

Many artists and writers — Agatha Christie, Neil Gaiman, and Jimi Hendrix, to name a few — claim that boredom produced the spark that set them on their creative path. Far from lacking stimuli this year, the financial sector has nevertheless come up with some creative solutions to tackle the challenges facing it.

In the second and final article of a two-part series, we look at three more key trends and challenges shaping the sector this year as well as some of the opportunities that have emerged for community financial institutions (CFIs).

Key trend: Evolution of fintechs and neobanks. Fintechs have massively disrupted the financial services sector over the past decade. Backed by cheap venture capital funds and only loosely regulated, they exploded onto the scene with their digital-first approach and personalized offerings. As of July 2023, fintechs had a market capitalization of $550B, according to McKinsey. However, the funding that fueled their exponential growth has returned to business-as-usual levels and valuations have dropped significantly. Fintechs are therefore entering a new era in which they are required to focus on sustainable and profitable growth. That said, McKinsey estimates that between 2022 and 2028, the fintech market will grow 3x faster than the traditional banking sector.

CFI opportunities: "Coopetition." The competitive threat from fintechs has dramatically accelerated digital transformation among CFIs in recent years. Lately, competition has converged with cooperation as CFIs have realized that partnering with fintechs can help overcome internal barriers, such as product and data silos and legacy infrastructure. Partnerships between CFIs and fintechs tend to fall into one of three categories:

1. Delivering operational efficiencies by applying third-party technology to existing processes, such as new account openings
2. Enhancing the customer experience, such as savings tools and person-to-person payment apps
3. Increasing the customer base by leveraging embedded finance, or Banking-as-a-Service (BaaS).

Key trend: Increased cyber threats. Increased digitization and interconnectedness have unlocked new avenues for increasingly sophisticated bad actors, causing extensive financial damage. In 2023, the average cost of a data breach in the US was $9.48MM. It is no surprise then that cybersecurity continues to dominate the list of risks faced by CFIs. In CSBS's annual survey, nearly 93% of respondents rated cybersecurity as either an "extremely important" or a "very important" internal risk. Some of the most prevalent threats include ransomware attacks, cloud security threats, AI-based attacks, phishing attacks, insider threats, and cryptojacking (a threat that penetrates a system and uses its resources to mine crypto assets).

CFI opportunities: Risk mitigation strategies. In response to these increased cyber threats, CFIs have invested heavily in cybersecurity platforms, with a median of $250K, according to Bank Director. Meanwhile, a survey of US banks by Integris found that just over half the respondents believe they are spending enough on cybersecurity — and are confident in the level of protection they have achieved. As well as implementing comprehensive security solutions, leading institutions ensure rigorous protocols are in place, evaluate third-party security, and regularly invest in training and building a cybersecurity culture. Moreover, they recognize the need to continually review their systems, processes, and preparedness in light of the evolving security landscape.

Key trend: Regulatory complexity. Regulator interest has intensified in many areas of the banking sector, including fintech partnerships, BaaS, BNPL, overdraft fees, fair lending practices, data protection, and money laundering. In Bank Director’s annual risk survey, 28% of respondents cited evolving regulatory or compliance requirements as one of the top three challenges facing their institution. For 70% of bankers, concern over compliance risk has increased in the last year. While penalties are issued by the regulators for noncompliance, an even greater issue is the potential damage to customers’ trust in the institution’s ability to look after their money.

CFI opportunities: Focus on compliance. CFIs are pursuing several strategies to stay on top of compliance while minimizing costs. These include investing in regulatory technology, developing a comprehensive IT governance framework, continuous monitoring and auditing, building relationships with regulators, outsourcing, and fostering a culture of compliance throughout the organization with regular training.

The changing fintech landscape, increased cybersecurity concerns, and regulatory complexity have created some additional challenges for CFIs this year. In a show of resilience, CFIs have responded by forging mutually beneficial partnerships with fintechs, boosting their cybersecurity defenses, and focusing on compliance — all of which benefit their customers. Next week, we sit down with PCBB President Mike Dohren to discuss industry trends for 2024.

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ECONOMY & RATES

Rates As Of: 12/06/2023 05:36AM (GMT-0800)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.45	0.00	1.03
6M	5.37	-0.01	0.61
1Y	5.05	-0.07	0.35
2Y	4.58	-0.10	0.15
5Y	4.14	-0.13	0.13
10Y	4.16	-0.17	0.28
30Y	4.29	-0.21	0.32
FF Market	**FF Disc**		**IORB**
5.33	5.50		5.40
SOFR	**Prime**		**OBFR**

5.33	8.50	5.32