Implementing FinTech: A Guide to Overcoming Barriers

October 2020

Contents

Introduction

The objective of the paper is twofold;

1. To raise awareness within the wider Irish Funds Industry of the potential low-risk nature and benefits of FinTech applications.

2. To guide Irish Funds Industry/FinTech firms on potential actions that could increase adoption and promote FinTech within the Irish Funds Industry.

The paper starts by looking at the current industry procurement process and the adopting fund industry participant ("Financial Institutions" or "FIs") organisational risks, then rotating to consider the issues, with regards to perceived barriers to implementation, from three perspectives, namely; FinTech firms, the Industry as a whole, and individual FIs.

Typical Industry Procurement Process

Each FI will have its specific on-boarding processes for technological solutions. However, by and large, they follow a similar structure encapsulating:

- Identification of technological gap
- Identification of potential solutions
- Proof of Concept
- Candidate Competition
- Procurement Process
- Implementation Stage

For the first two stages, there would, in most instances, be an internal champion who is advocating for the solution to be employed – this is usually the direct beneficiary of the solution and the party who identified the technological gap. For this reason, as the champion is the driving force and there is little risk or cost at this early stage, a proposed technology implementation project generally moves quickly to the point where an in-principle recommendation is made to the board of the FI.

Once the project reaches a point a formal decision is required, the process of justification begins, where the champion must convince the decision-makers of the merits of the project. The decisions makers have a variety of factors which must be considered, which all must be satisfied before the project can continue.

Factors to be considered include:

- Cost of the project
- Maturity of the proposed technology
- Risks and the benefits to the organisation

FinTech firms need to appreciate that there are risk mitigation requirements imposed on the decision-makers, dictated not only by good business practice but also by the relevant regulators.
Risk factors which the decision-makers must consider include:

- Contractual and financial commitments of the FI
- Vendor risks, including financial viability and concentration risks
- Technological risks including cloud, GDPR and data security concerns.
- Adoption risk
- Reputational risk

Solutions and proposals should be structured to alleviate as many of these risks as possible, for example, short minimum or initial contract terms until the solution is proven, giving the vendor the opportunity to demonstrate the effectiveness of the product's functionality, fostering confidence in the solution within the FI’s organisation.

The risks that the board of the adopting FI must consider include:

- Fiduciary Responsibility – the directors of the adopting FI must always prioritise their responsibility to their shareholders in considering any new project or implementation, chief amongst them the risks to the FI. This is enforced from a regulatory standpoint through the due diligence requirements imposed by the regulators, which prescribe a minimum due diligence standard. However, each FI will have its own individually tailored due diligence requirements. This can prevent the FinTech firms from developing a one-size-fits-all risk assessment response – a point of frustration amongst and additional cost for FinTech firms.

- Financial risk – any proposed technology project will undergo a cost-benefit analysis, which must be considered by the board to determine the project's likely effectiveness in the ultimate goal of maximising returns on investment. While FinTech firms value agility and flexibility in their technology, the contractual terms offered by them need to respect the fact that long term commitments will increase the financial exposure and risks to the FIs and therefore impact on board level deliberations.

- Counterparty Risks – in considering any new vendor relationship, FIs must evaluate the potential vendor organisation from the perspective of stability and sustainability. FinTech firms are typically small, young and vibrant, which is an asset in terms of technological innovation. Still, when viewed through the prism of risk assessment, this means that they usually score on the wrong end of the risk scale. If core processes are placed in the stewardship of unproven partners, the risk of failure falls on the FI and as a result, the maintenance of additional solutions as contingencies become increasingly important.

- IT risks – any engagement with a third-party technology vendor carries with it a range of risks specific to the technology being implemented. These may include cloud connectivity concerns, which potentially exposes the data of the FI to malicious actors, outsourcing of critical operational functions reliant on third-party support structures, or regulatory matters from a GDPR/data Security perspective. All these must be considered in any engagement proposal.

FinTech firms must appreciate these considerations when structuring their products and designing their offerings. Conversely, as discussed below, the FIs will need to open themselves to a rapidly developing market of potentially game-changing technology solutions which have emerged from a less traditional environment offered by Fintechs who are trying to adapt to conventional and regulated corporate environments.

1. FinTech Perspective

FinTech firms decreasingly view themselves as competitors with FIs and would rather see themselves as potential partners. FIs and FinTech firms all stand to benefit if the process for FinTech adoption, interaction and engagement is balanced.

However, it is still apparent that collaboration between FIs and FinTech firms remains a time-consuming and challenging process for both parties. Organisational barriers slow smooth and efficient FinTech adoption.

The Irish Funds FinTech working group asked the question: Why the limited collaboration? What are the barriers? And can we as a working group support increased adoption, interaction and engagement to create awareness of the mutual benefits to collaboration?

The Irish Funds FinTech working group had a unique opportunity through the Irish Funds FinTech Factor initiative to ask participants to describe the FinTech on-boarding process from their experiences and perspectives. We did this by completing a mini-survey with the FinTech Factor participants on their views on the on-boarding process.

About the survey

The FinTech Factor participants were surveyed through a questionnaire exploring their perspectives of the on-boarding process. For this paper, the on-boarding process is broken down into four stages, specifically prospecting, proof of concept, procurement and implementation.

Results

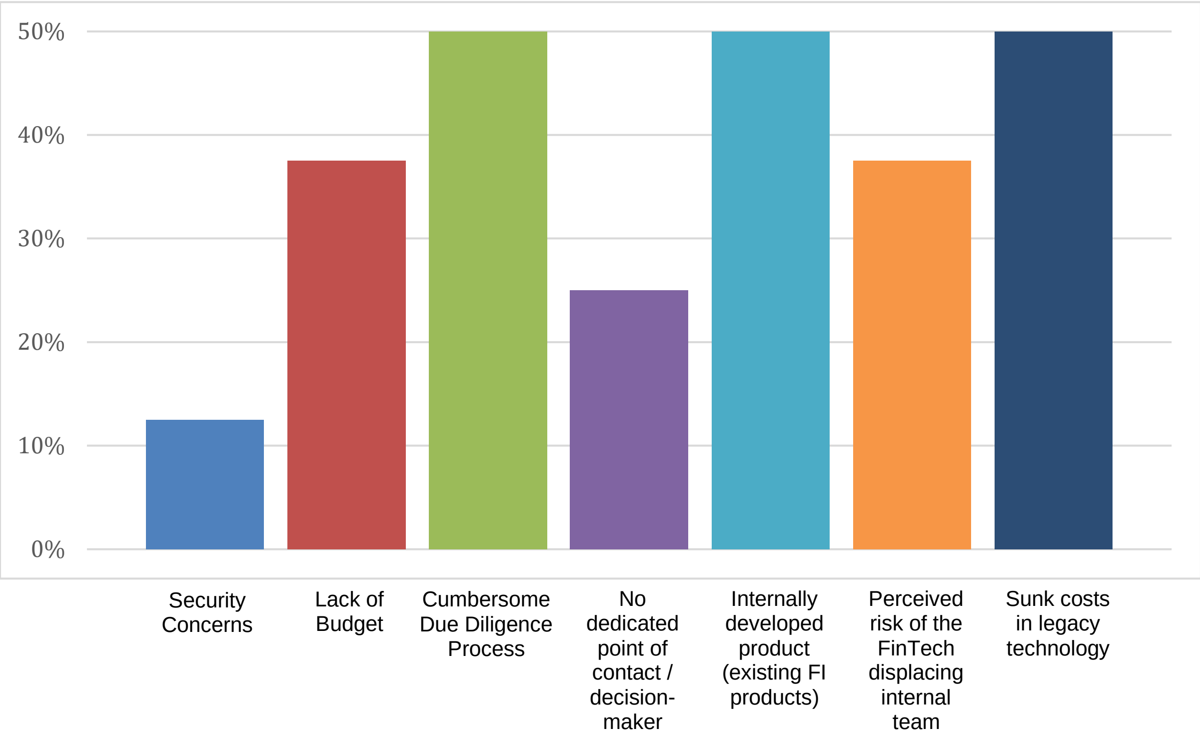
The overall finding from the survey for the perspective of the FinTech firms was on-boarding is time consuming and complicated. Also highlighted through the survey is the fact that FinTech firms can struggle to move through an FI's implementation process efficiently.

Prospecting

100% of the FinTech firms reported that prospecting ("Request for Proposal" or "RFP") takes longer than four months. Also, 71% of FinTech firms highlighted that 1-3 staff from the FinTech are involved. It was noted, however, that across the FinTech firms surveyed the average number of employees involved in responding to RFPs was 9. This highlights the significant focus, resource and time commitments required from the FinTech during the prospecting stage. It also highlights that during this time the FinTech is 'all-in' for a particular RFP, and due to their typical small size, other pipeline opportunities may therefore fall by the wayside.

Best practice underlines the need for a dedicated point of contact in the FI to enable a smooth and efficient prospecting process, according to over 80% of the FinTech firms surveyed. However, the FinTech firms highlighted throughout the survey that the lack of dedicated FI resources during the RFP process compounds slow progress.

55% of FinTech firms cited cumbersome FI due diligence processes, continued reliance by FIs on internally developed/existing products and the sunk cost in legacy technology, as the top 3 stumbling blocks hindering advancement from prospecting to proof of concept.

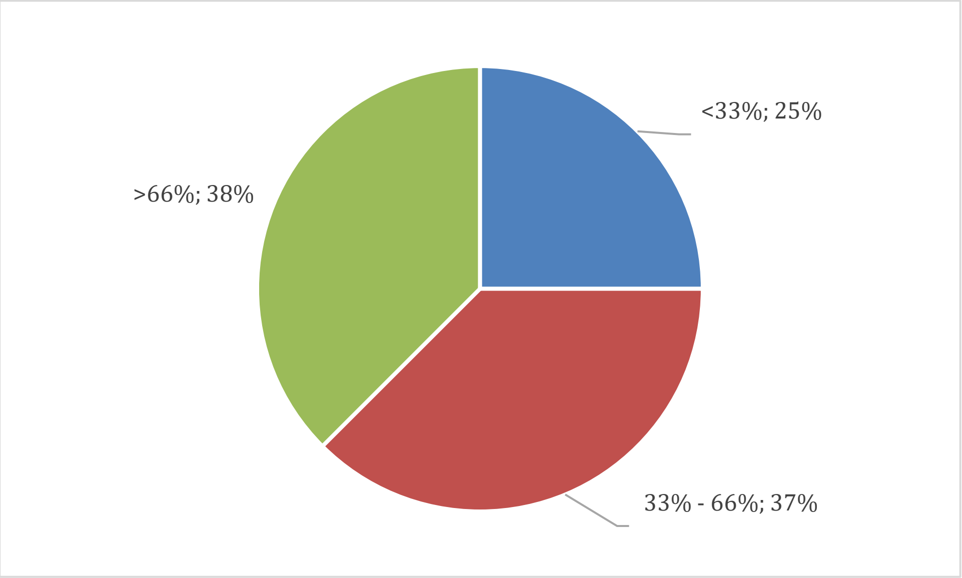


Proof of Concept

Perceived as being agile, FinTech firms have experienced, on average, a four-month relationship with the FI from the start of the RFP as the process transitions into the proof of concept (PoC) stage. However, issues continue to arise, which stall progress.

60% of FinTech firms highlighted that the lack of dedicated FI resources and the lack of alignment between the use case and product roadmap can contribute to a smooth PoC not always being possible. Also, 50% reported that PoCs took longer than two months to complete.

Ultimately, regardless of the time taken, success is defined whether a proposal makes it through PoC stage to implementation. Among the surveyed FinTech firms, only 38% reported more than two thirds of their products or services converting from PoC to implementation.

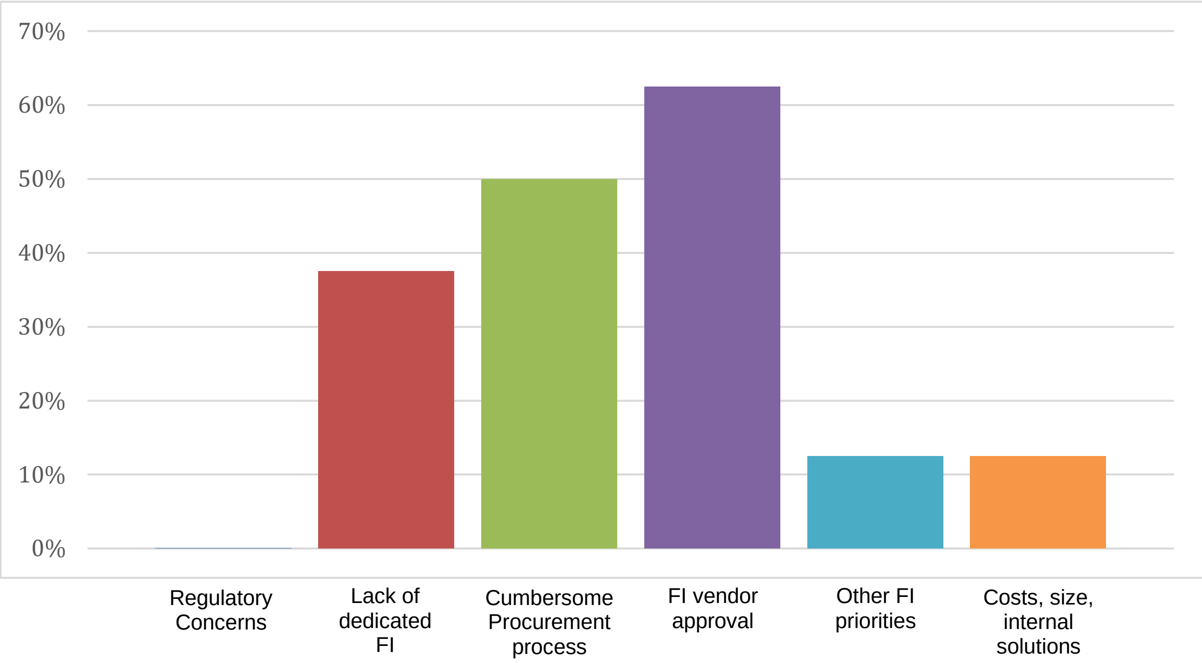


Note: Above chart shows percentage conversion from PoC to implementation for three conversion ranges – a) <33%, b) 33-66% or c) >66%

Procurement

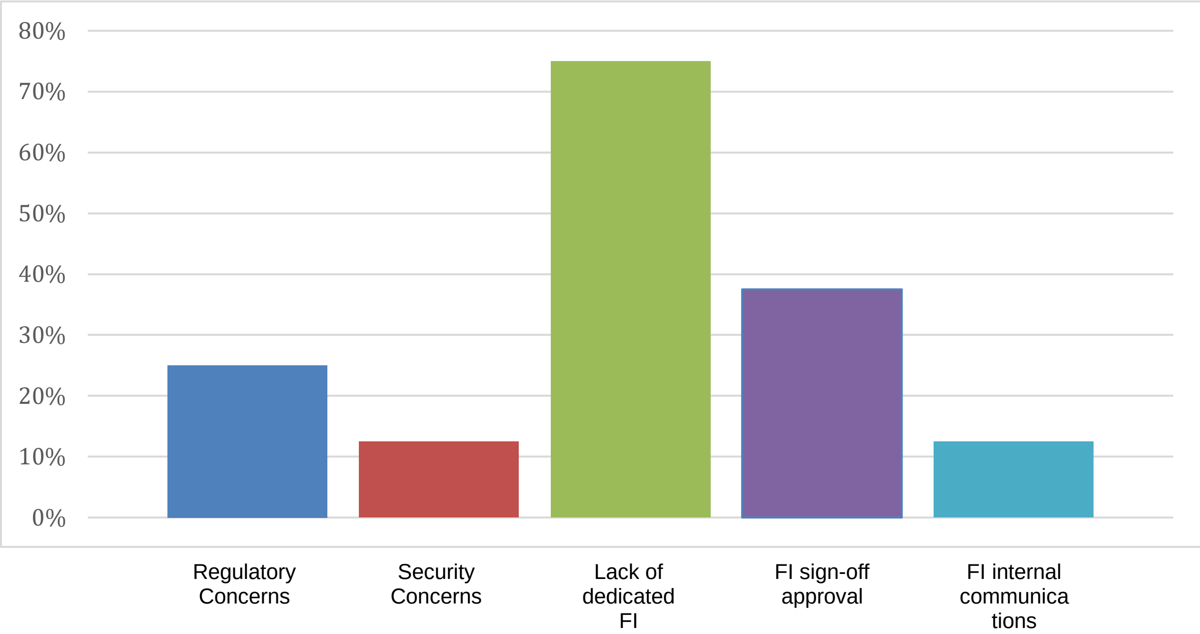
At least 50% of the FinTech firms surveyed reported the procurement process lasts a further four to six months.

64% of FinTech firms cited a cumbersome procurement process and slow FI vendor approval as reasons hindering the procurement process.



Implementation

Once again, while FinTech firms highlighted the lack of dedicated FI resources as the most significant contribution to slowing down the implementation stage, regulatory concerns were also cited as one of the challenges encountered during the implementation phase.



The timelines and duration of the on-boarding process reflected in the survey are likely to be a cause of concern for newer and smaller FinTech firms. The challenges revealed by FinTech firms in the survey highlight the need for greater efficiency in PoC and procurement processes, more closely aligned communication and transparency between FIs and FinTech firms, as well an acknowledgement of shared concerns and objectives.

Industry Based Barriers to Implementation

Regulation

Regulations often constrain the FinTech industry. One of the main concerns is the complications presented by strict and often rapidly changing industry regulation. It is hard to be innovative when a product needs to meet those regulatory standards or may require approval from regulators. While the initial purpose of regulation is protection, regulation may also work to deter many FinTech firms from entering the market. While regulations are critical to protecting customers, too many and overlapping regulations can significantly slow down the adaption of new technologies.

To tackle some of those problems, regulators from a number of countries around the world have created regulatory sandboxes and innovation hubs. These can offer a range of benefits, by facilitating a healthy dialogue between FinTech firms, regulators and supervisors about the deployment of new technologies.

There is only one financial services regulator in Ireland, the Central Bank of Ireland (the "Central Bank"), which is responsible for authorising and supervising providers of regulated financial services, including FIs. There is no dedicated FinTech regulator in Ireland.

The Central Bank has made a significant effort over the last years to work with both industry and the FinTech industry to facilitate increased adoption of Fintech solutions. The Central Bank has recognised that advancements in technology could bring substantial benefits to consumers and the economy but has also acknowledged the risks that can come with this. As part of its initiatives to help facilitate Fintech, in April 2018 the CBI launched an Innovation Hub designed to facilitate an open and active engagement with the FinTech sector. The Innovation Hub allows FinTech firms to engage with the Central Bank outside of existing formal regulator/firm engagement processes. This is designed to help the FinTech firms to navigate the regulatory landscape in a controlled environment. It has the added benefit of allowing the Central Bank to gain an early sight of new technologies and evolutions in the financial services industry, so that it can better understand the potential risks and potential mitigants.

In addition to providing an access point for firms to contact the Central Bank, the Innovation Hub openly and actively engages with a broad spectrum of innovation-related stakeholders, including academics, industry associations, other regulators, incubators and accelerators. To date, the Innovation Hub has facilitated 52 stakeholder engagements. [Central Bank of Ireland, Innovation Hub, 2019 Update].

The next necessary step to facilitate the regulatory journey of FinTech firms is the creation of European standards and harmonise the regulations across the different jurisdictions.

Finding the right contacts

When starting any business, it is hard to find the right people to support the business and even harder to be connected to potential customers. Most FinTech firms struggle with this issue when starting up their business.

Industry organisations could provide support to guide Fintechs throughout networking process and bring them in contact with the right people. The most known industry organisations in Ireland supporting FinTech firms are Irish Funds, the FinTech and Payments Association of Ireland, the Banking and Payments Federation of Ireland, FinTech Ireland and Financial Services Ireland.

Over the years, the number of incubators and accelerators in Ireland has grown significantly. Incubators mainly focus on start-ups and support them by providing them with management training and office space. Accelerators expedite the growth of existing FinTech firms, which have already a minimal viable product, and support them mainly with seed-money, mentorship and connections in the industry. Multinational financial services companies such as Citibank, BNP Paribas and Bank of Ireland host innovation hubs to support FinTech firms looking for experience and funding. However, not all Fintechs have access to these supports.

Even though industry organisations could be a significant benefit for FinTech firms, most do not work closely together to share experiences. The various industry organisations work independently from each other and would benefit from a coordinated approach. In addition, the membership fee for certain industry bodies could be perceived as a barrier to more active participation from FinTechs firms; a time limited mezzanine fee could be considered to help address this.

Funding

Funding and support are the critical issues for start-ups. However, most of them are so focused on the product that they do not spend enough time on their investor pitch deck or marketing. The result is that they frequently do not reach enough or the right potential investors.

Funding is available to suitable start-ups from the Irish government, through organisations such as Enterprise Ireland, via various forms of grant aid.

Enterprise Ireland offers a comprehensive range of supports to high potential; expert focused entrepreneurs and companies on making it as easy as possible to start a business in Ireland and to grow into global markets. They provide business funding, advice and mentoring.

Enterprise Ireland also has relationships with many local Business Angels, Seed Funds and Venture Capitalists (VCs) and can arrange introductions if required.

- https://www.enterprise-ireland.com/en/Start-a-Business-in-Ireland/Startups-from-Outside-Ireland/Funding-and-Supports-for-Start-Ups-In-Ireland/Funding-and-Supports-for-Start-Ups-in-Ireland.html

Ireland's very favourable tax regime can also help make companies based in Ireland more attractive to investors. This includes a low corporation tax rate of 12.5%, combined with favourable double tax agreements and generous R&D tax credits available to start-ups in Ireland.

FI Organisation Based Barriers to Implementation

Potential barriers to implementation are embedded in FI processes, and there are some points which FIs can consider to aid adoption rates of the FinTech solutions within financial services.

Organisation Risk appetite

How can a FinTech firm get an audience with a global organisation, to even consider its solution? Each FI has a different culture, risk appetite and openness to change. We have seen from the responses to the survey that the procurement phase and the focus on the financial aspect of the due diligence process, as well as the fact that many FIs are traditionally risk-averse, that this can disadvantage new or small FinTech firms. So how can an FI re-assess its risk stance, to avoid potentially missing out on that Fintech golden ticket?

The FinTech firm could consider its proposed contractual terms to a FI, with regards the implementation fees, duration terms and conditions of the contract – with the option for the FI to walk away with a limited financial investment if it does not result in the success as intended. The FI may choose to road test a FinTech solution for one part of the operational process, to aid the due diligence exit plan, thereby limiting exposure where needed. On the flip side, if this limited implementation goes well, there could be scope to scaleup the FinTech solutions within the FI to other parts of their operational processes that maybe under review consideration as FIs adapt to the dynamic landscape of the industry. In the current climate, there has been recent growth in the number of organisations considering cloud adoption solutions, which aids reduction in capital expenditure as an alternative to on-premises technology. The FIs want more done at lower cost to help manage operational expenditure, thus creating an opportunity for FinTech firms to meet these demands.

Early Adoption

Empirical evidence also shows that early adoption can help both parties, where an FI chose to select a FinTech solution. At the early stages, the product is still in a beta phase, so open for tailoring for client's requests. However, the FinTech solution is a better road-tested product in the market as a result. This helps FinTech firms to sell their solution as a working solution, potentially with the added benefit of an FI reference or press release aiding future growth. A FinTech firm with the right mix of technical and operational experience, can adapt easily to these client requests. FinTechs tend to be more flexible and cloud-based, and therefore tend not to restrict the frequency of enhancements, as these can be pushed out in a short window once successfully cleared in the test region. As a result, the FI also benefits from a faster return on its investment, with an agile solution for its needs which is adaptable in a timely manner. Recent examples of these benefits can be seen in the case of RegTech firms which, due to COVID-19, were in a position to implement rapidly across their customer bases, revised investment restrictions in volatile markets. This shows the benefits to organisations which had automated their compliance obligations with agile, cloud-based solutions, enabling them to maintain operations and regulatory compliance in a short timescale.

Procurement

Getting a foot in the door can be challenging. However, the demo to the right person in the FI plus when the FI are possible considering a change in their operating model, could lead down a fruitful path. Many FIs with a global structure across various industry markets may still require sign-off from global HQ where there is local demand for a FinTech solution. A demo with a key influencer in an organisation, would be preferred as in some cases decisions can be made quickly and the influencer can ensure that the contract lands on the appropriate desk for action. For a global organisation, a selection of preferred suppliers is critical, as procurement aims to standardise the vendors used globally to streamline processes. If a FinTech firm is successful in gaining traction with an FI, in helping resolve small items, using measurable management information and the experience of the operational staff (with regards the ease of use of the product), this should aid the organic growth of sales not only within the local FI, but potentially to other global locations of the FI.

FinTechs are increasingly important components of the industry, with some FinTech challengers having grown into sophisticated competitors, with an increasingly global reach. From a Gartner press release in October 2019, it forecast that by 2030, 80% of financial firms would either go out of business or be rendered irrelevant by new competition in the marketplace, changing customer behaviour and advances in technology. For a FinTech, knowing its client's business is essential, including its use of current systems and how those systems interface with other systems or manual touchpoints. This knowledge of potential clients when utilised by the FinTech as part of their demo or sales pitch to an organisation, can peak the interest of the audience, where the solution clearly outlines the potential benefit of operational efficiencies, more flexibility, less risk and improved links between their critical systems as examples. Following a demo with a FI the FinTech may also have a greater insight into the organisation’s current resource cost and pain points, to potentially aid progression on the path to selection.

Due Diligence requirements

One of the leading organisation barriers is the lack of standardised due diligence questions from FIs, even in the same industry. This impacts the sales cycle for FinTech firms, where a potential new client looks for similar information already provided to an earlier client, but in a different and individual format. This can require wasteful resource and time commitments to decipher the request and repackage information. On the flip side, FinTech firms need to have their due diligence in order, particularly when pitching to regulated organisations (e.g. having the relevant ISO certification can curb some of the information security questions). Given the regulatory obligations of specific FIs in the current cyber security market, it will also be a factor in their risk assessment of FinTech solutions, to avoid business disruption and reputational damage in the event of an incident / breach.

Finally, in these current times, it may bring opportunities, as the trends in the FinTech space eventually flow into the financial services industry, e.g. working from home, cloud-based solutions. Those organisations that continue to ride the wave have scope to adapt early to the emerging solutions to manage both client service via operational excellence and cost management on agile solutions.

Conclusion

Outlined above is an outline of some of the reasons why the selection and implementation of FinTech solutions in the financial services industry is challenging. Some of these are due to inertia and traditionalist thinking on the side of the FI, whereas other arise from an under-appreciation within Fintechs of the regulatory and organisational controls that must come with any investment decision on the part of and FI and which consequentially should be a factor in the investment decisions the FinTech firms.

These two strands combine to create a contradiction where the underlying solution to the FI's regulatory or process challenges can be met using agile and flexible technology, but the FI's processes are conservative when it comes to adopting these solutions and can be mired in organisational or regulatory-driven safeguards.

The FinTech phenomenon needs to be appreciated for what it is – flexible technology-driven solutions, often with minimal implementation costs and a speedy timeframe to achieve the gains or pull the plug.

Not all FinTech solutions will work for all organisations. However, if both FI's and FinTech firms can alter the approach, more organisations will be encouraged to investigate the possibilities, and both FIs and Fintechs can achieve the benefits they want.

FinTechs, which tend to succeed, tend to be transparent and come prepared and are naturally curious about the organisation to which they are pitching.

Now is an opportunity for FIs to embrace change and become more strategic, consider new suppliers in the market and conduct a cost reset, which can also aid manage cashflow in the current climate.