



# Refining your FinTech Strategy

What you need to know

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# Course Agenda

- FinTech Background
- Strategic Considerations
- Due Diligence and Ongoing Monitoring
- Accounting Considerations



# FinTech Background



# Key Terms



## fin·tech

/ˈfin.tek/

*noun*

Products and companies that employ newly developed digital and online technologies in the banking and financial services industries.



# Key Terms

## Banking as a Service (“BaaS”)

A partnership model in which a financial institution leverages its bank charter to enable one or more non-bank financial services companies to offer products directly to customers.

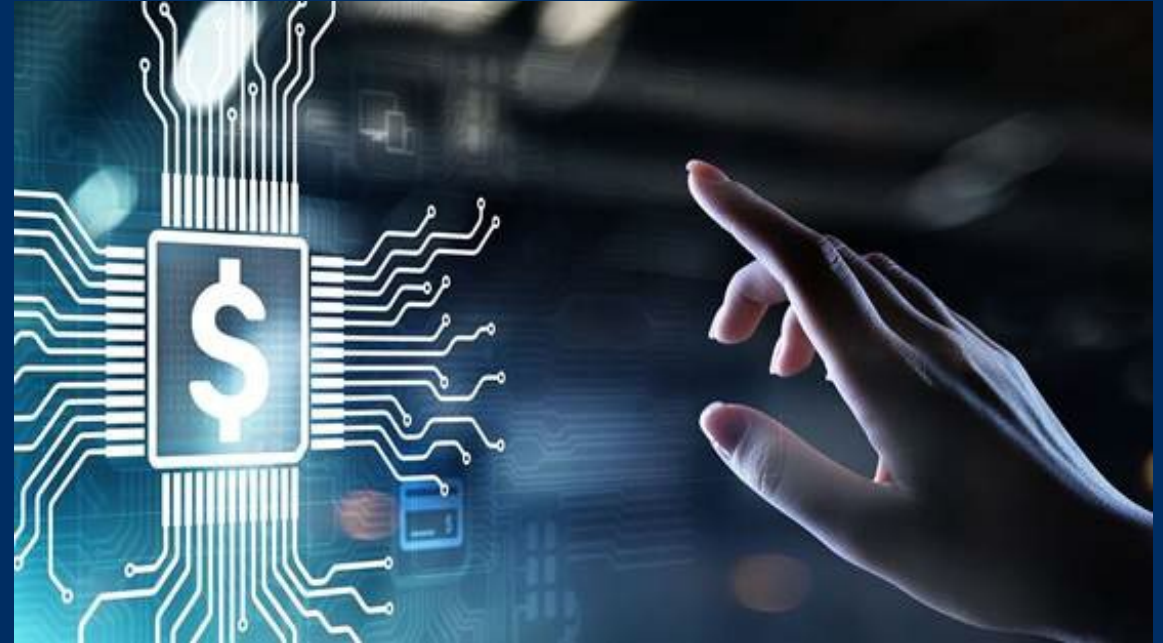
## Bank of Record / Sponsor Bank

Financial institution offering BaaS. Non-financial companies may list their sponsor bank as the “bank of record” on legal disclosures.



# FinTech and BaaS Market Trends

- FinTechs becoming banks
- Banks directly investing in FinTechs
- Banks investing in FinTech funds (i.e., JAM FINTOP, Canapi Ventures)
- Banks embedding FinTech
- Banks providing Banking as a Service to FinTech partners



# FinTech Verticals



## PAYMENTS

Payments processing, card developers, money transfer platforms, and tracking software



## BANKING

Digital-first banks or companies digitizing banking services for credit and debit



## ALTERNATIVE LENDING

Companies creating new solutions for personal or commercial lending



## WEALTH MANAGEMENT

Personal finance tools, investment and wealth management platforms, and analytics tools



## INSURANCE

Companies selling or distributing insurance digitally or providing data analytics and software for (re)insurers



## CAPITAL MARKETS

Sales and trading, analysis, and infrastructure tools for financial institutions



## SMB

Companies focused on providing solutions to small- and medium-sized businesses



## REAL ESTATE

Mortgage lending, transaction digitization, and financing platforms

# Strategic Considerations





# How to Get Started

- Understand the strategic purpose:
  - Internal
  - External
- Board – strategy start with the board
  - Diversity of thought on board to think digitally / efficiency

# Potential Disrupters

- Money
- People
- Regulation
- Data Governance
- Actionable to Scale
- Reputation
- Forecasting and financial planning



# Due Diligence and Ongoing Monitoring





# Due Diligence and Ongoing Monitoring Areas



DUE DILIGENCE  
TOPICS



IT SYSTEMS AND  
CONTROLS



VENDOR  
MANAGEMENT

# Conducting Due Diligence on Financial Technology Companies

## A Guide for Community Banks

AUGUST 2021



Board of Governors of the  
Federal Reserve System

Federal Deposit Insurance  
Corporation

Office of the Comptroller of  
the Currency

## Regulatory Guidance – Due Diligence

1. Business Experience
2. Business Strategies and Plans
3. People
4. Financial Condition
5. Market Information
6. Legal and Regulatory Compliance
7. Risk Management and Controls
8. Information Security
9. Business Continuity

<https://www.federalreserve.gov/publications/files/conducting-due-diligence-on-financial-technology-firms-202108.pdf>



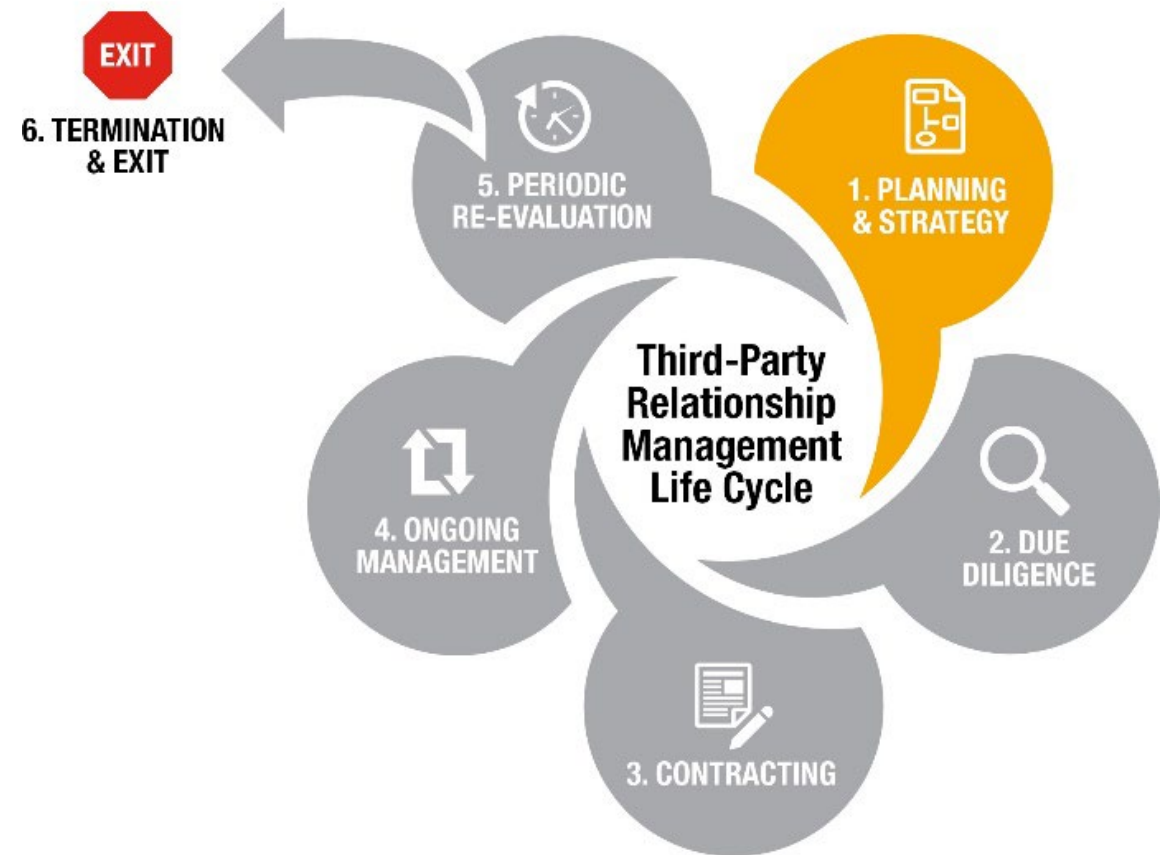
# IT Risk and Compliance Consideration

- Compliance Best Practices
  - IT Risk Assessment
  - System and Organization Controls (SOC) Reporting
  - Network Security Assessments
  - Payment Card Industry compliance data standards (PCI)
  - Cyber security insurance
  - BSA/AML Risk Assessment
  - KYC Risk Assessment



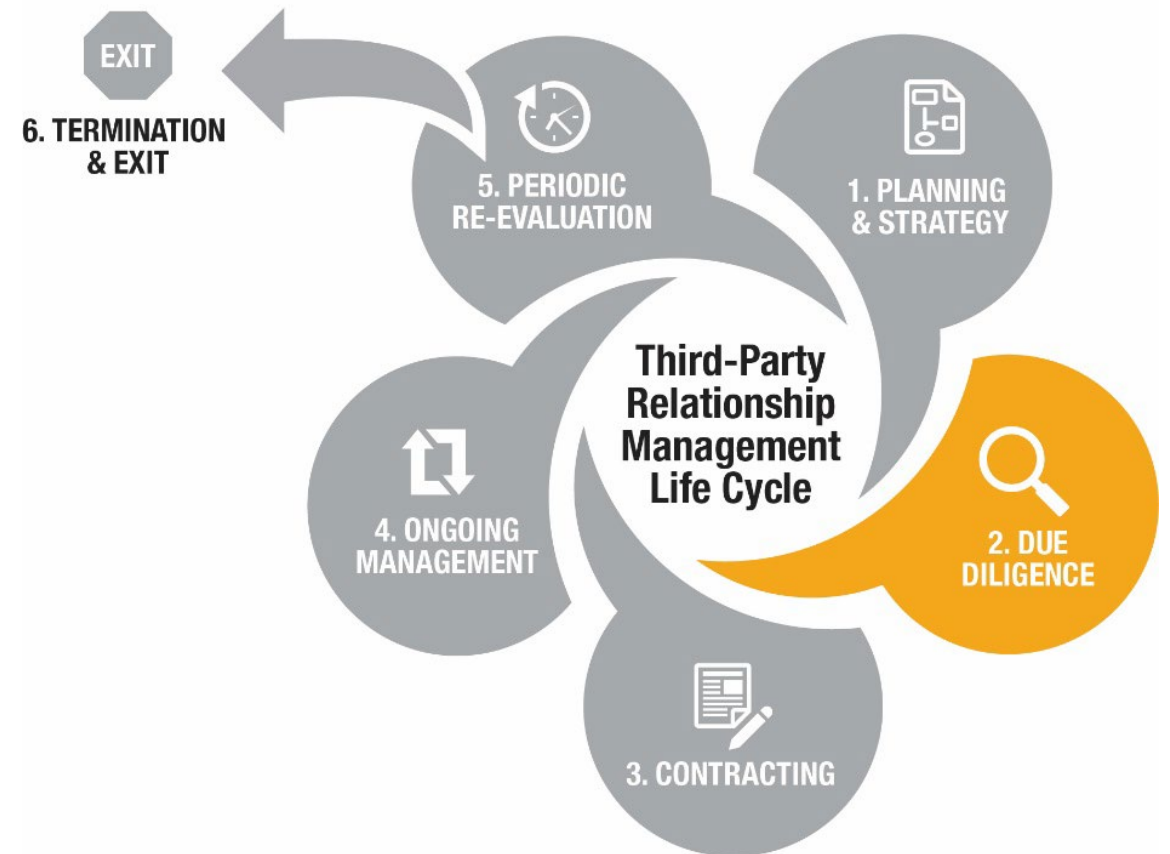
# Third-Party Risk Management Life Cycle – Planning and Strategy

- Utilize a vendor vs. keep in-house
- Answers the question, “Why or why not?”
- Strategic purpose of FinTech



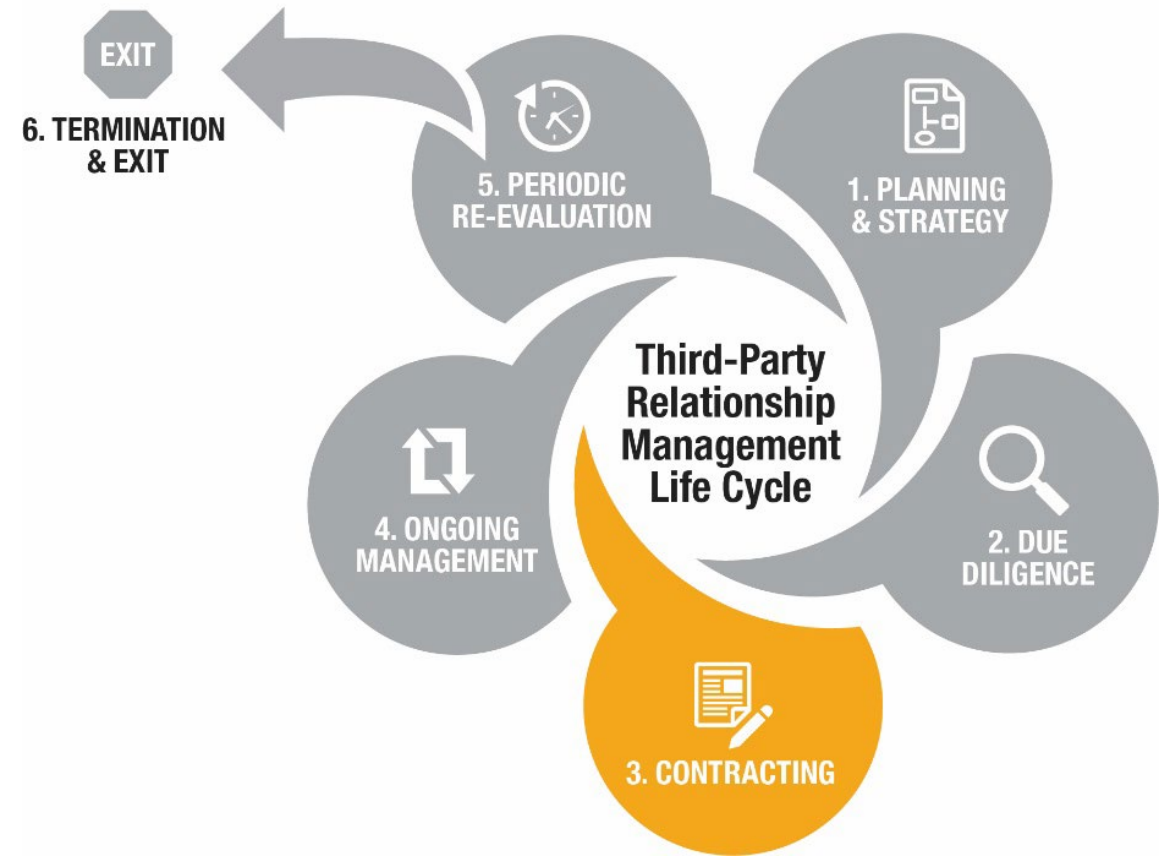
# Vendor Management – Due Diligence

- What are the inherent risks?
- What controls are in place at the third party to mitigate risk?



# Third-Party Risk Management Life Cycle – Contracting

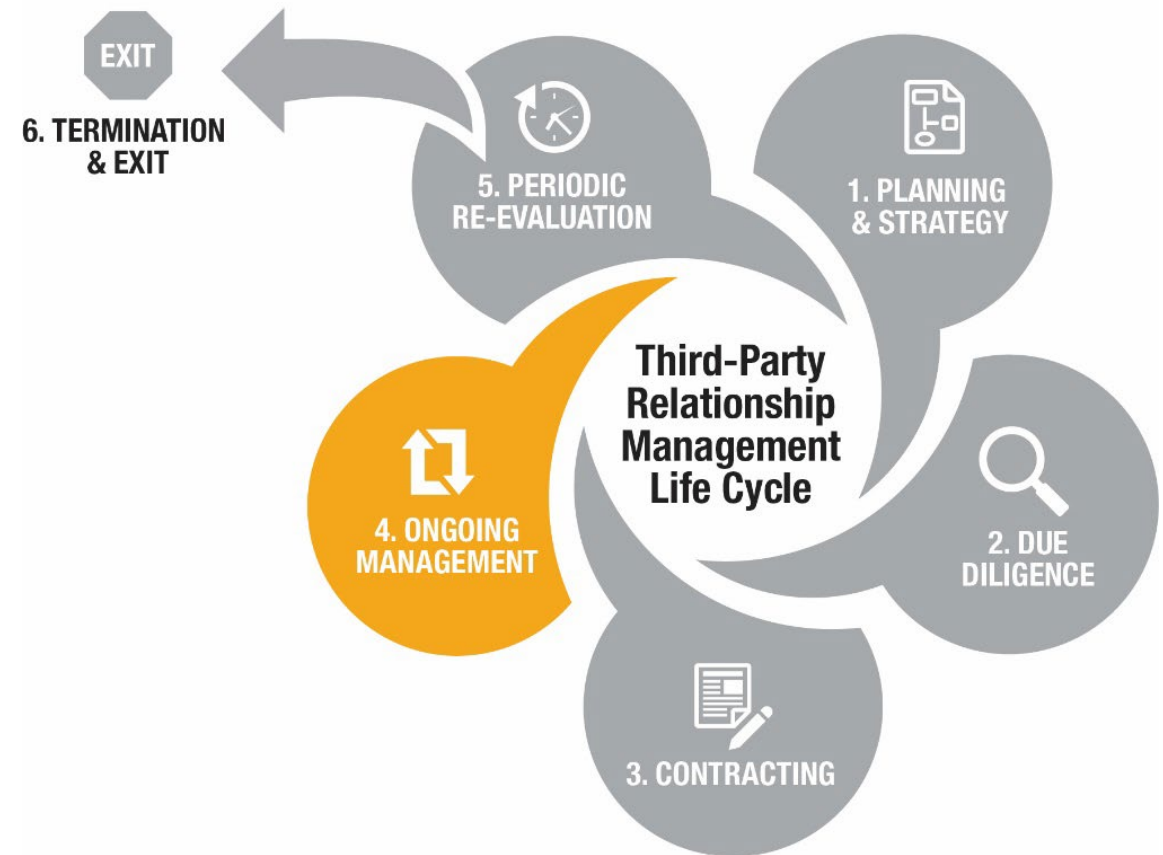
- Define expectations and responsibilities
- Who has the authority to enter into contractual relationships?





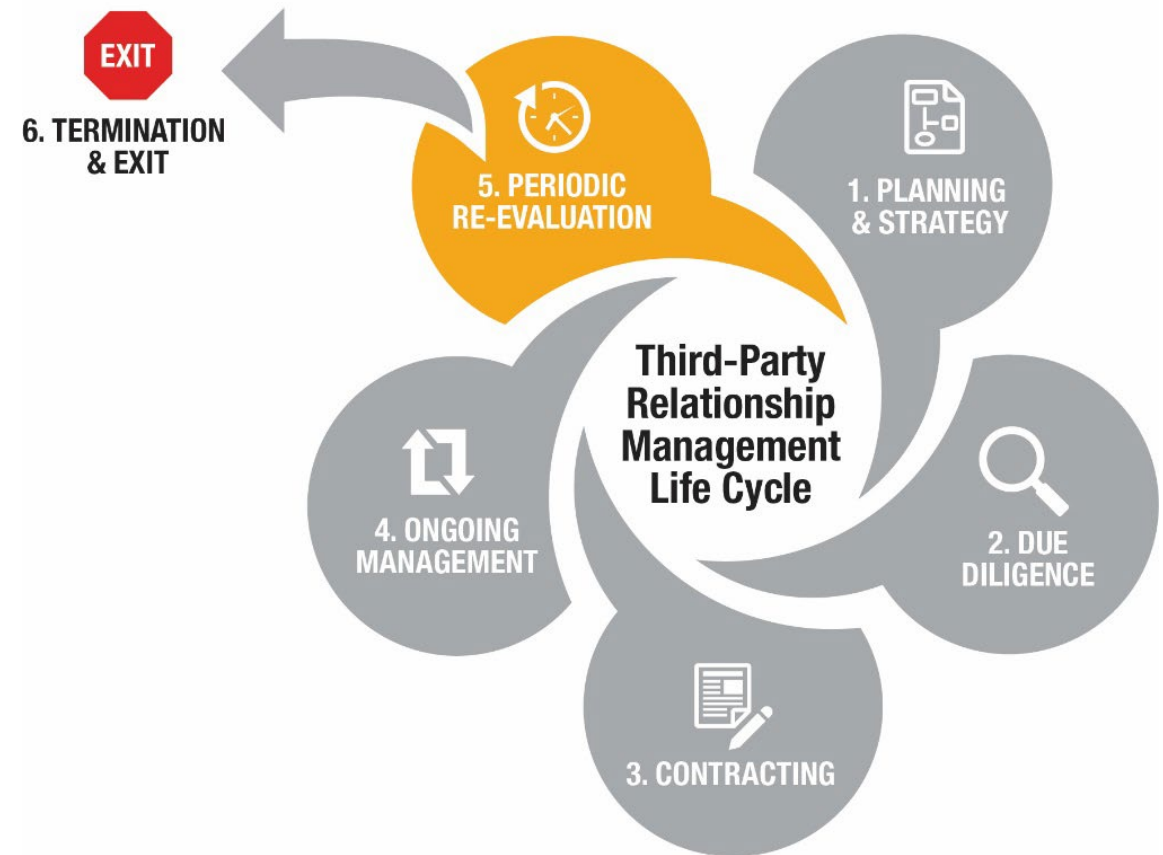
# Third-Party Risk Management Life Cycle – Ongoing Management

- Performance against Service Level Arrangements
- Changes to 3<sup>rd</sup> party management and delivery
- Findings administration
- Monitoring for reputation, litigation, financial viability, and complaints should be done periodically, if not continuously



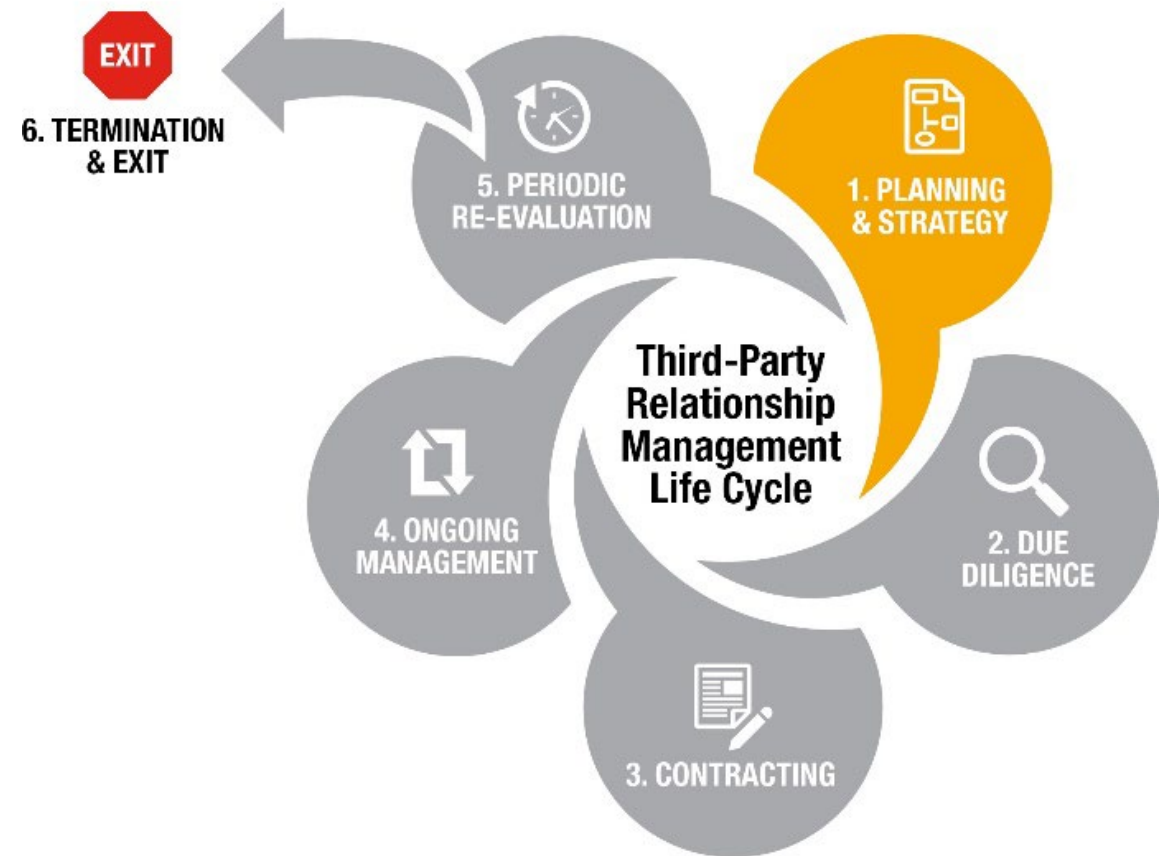
# Third-Party Risk Management Life Cycle – Periodic Re-Evaluation

- How frequently is the vendor reviewed?
- Evaluation frequency is based on the level of risk of the third-party:
  - Higher risk = Re-evaluate more frequently



# Third-Party Risk Management Life Cycle – Termination and Exit

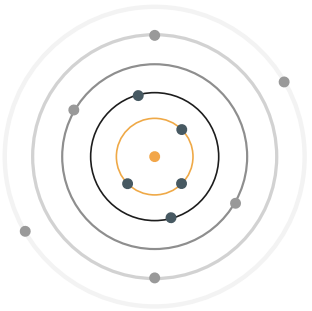
- Risk associated with:
  - Data retention/destruction
  - Information system connections
  - Access control issues
- How to handle joint intellectual property
- Risks to company's reputation





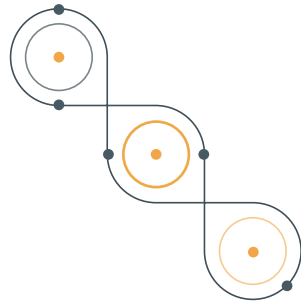
# 5 Tips for enabling risk management within FinTech partnerships.

01



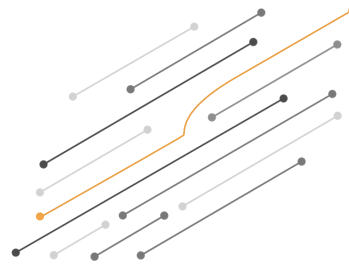
**Strategy Alignment  
and Complementary  
Objectives**

02



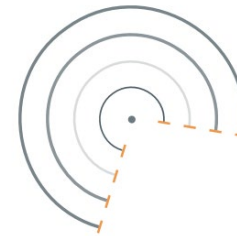
**Cultural alignment  
and transparency**

03



**Operational  
resilience, capacity  
and compatibility**

04



**Embedded risk  
management and  
compliance**

05



**Agree to a plan  
that's not 'check the  
box'**

# Accounting Considerations



# Accounting Complexities – FinTech Fund Investments

- Considerations
  - Nature of investee
  - Level of ownership and control
- Methods
  - Equity investments
  - Equity method investments
  - Consolidation

# Level of Control

## Ownership

- Significant ownership
- Significant influence
- Not significant influence

## Other Factors

- Board seats
- Significant transactions, policy making
- Reliance on technology
- Concentration of ownership



# SEC Guidance for Limited Partnerships

*The SEC staff's position on the application of the equity method to investments in limited partnerships ... requires the use of the equity method unless the investor's interest "is so minor that the limited partner may have virtually no influence over partnership operating and financial policies." The SEC staff understands that practice generally has viewed investments of more than 3 to 5 percent to be more than minor.*

- Note: similar guidance is included in the call report instructions glossary

# Revenue Recognition Consideration

- Revenue recognition
  - Identify contracts with your customer
  - What portion of the contracts are within the scope of ASC 606?
  - ASC 606 considerations
  - What about the non-ASC 606 items?

# Lending Consideration

- Who is your customer – the FinTech or the individual customer?
  - Legal lending limit issues
  - Appropriate call report classification
- Interest-sharing arrangements
  - Presentation considerations



# Tax Considerations

## Information Reporting

- Who is the actual Payer and Payee – Bank or FinTech?
- Who will gather the information to report?

## R&D Credits

## State and Local Issues

- If engaging in lending or fee-generating business, who is the customer?
- Are reimbursements for loan or fraud losses viewed as revenue or as contra-expenses for apportionment and gross-revenue tax purposes?



# Internal Control Consideration

- Evaluate ownership changes each quarter - should there be a change in accounting?
- Evaluate the income reporting, internal company transaction quarterly for equity method (significant influence)
- Evaluate the fair value of the entity quarterly to record changes.





# Questions? Thank you.

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