allison

BANKING-AS-A-SERVICE

WHITE PAPER

COMPLIANCE MEETS OPPORTUNITY

Banking as a Service (or BaaS for short) describes a model in which licensed banks integrate their digital banking services directly into the products of other non-bank businesses. This way, a non-bank business, such as a Fintech company, can offer its customers digital banking services such as mobile bank accounts, debit cards, loans and payment services, without needing to acquire a banking license of their own.

What is “Fintech”(Financial Technology)?

Fintech is a catchall word. And like any catchall word, its usage is broad and with blurred lines that can result in misunderstandings. At their core, ***fintech companies move money***, and they do this to enable things like saving, investing, and lending. Generally, they are built to facilitate money transfers, making them quicker, more reliable, and more cost-effective.

In other words, fintech companies can look vastly different from one another. When talking about business-to-consumer (B2C) products, one might think about Venmo or PayPal. With business-to-business (B2B), you have corporate payroll and HR solutions like Gusto, global payments and remittance platforms, virtual credit cards, debt management apps, and crypto wallets. At the end of the day, all of these fall under fintech’s giant umbrella.

A common misconception is that fintech refers only to young, hip startups with hoodie-clad employees working from beanbag chairs. However, the reality is that the classification just as accurately applies to many 50- or 60-year-old companies that, over the years, have modernized their processes to fit the changing times. The primary requirement for being a fintech company is using technology to improve the speed, accuracy, and efficiency of financial transactions and their activities.

Fintech touches all of us.

At this point, it’s more difficult to avoid interacting with a fintech company than not. Whether through business or everyday life, financial technologies have all but thoroughly permeated even our most basic money-related activities.

Building your savings, paying bills, using your credit card online, making charitable donations, repaying a loan, sending a friend some cash – by now, all of these interactions rely heavily on fintech products.

And for business owners, the situation is the same. If you’re paying rent or a mortgage, disbursing payroll to employees, compensating vendors, or managing assets, you’re likely using fintech applications.

What is a “Money Services Business”(MSB)?

A “Money Services Business” or “MSB” is the term used by Financial Crimes Enforcement Network (FinCEN) to describe and identify businesses that issue or exchange currency, checks, and storedvalue cards, including those entities that transmit money as part of their core business offering.

MSBs must register with FinCEN at the federal level and then obtain licensure from each individual state regulatory agency that has purview over granting and administering Money Transmitter Licenses (MTLs) in their respective states. Typically, this falls under the jurisdiction of the state Banking & Finance Commission (or equivalent). This registration and licensure process is timeconsuming and comes with significant expense.

Examples for consumers and businesses include:

- lending, savings, investment
- bill payment and banking
- prepaid and credit card

How do Community Banks/Credit Unions fit into these developments?

A few years ago, popular opinion among critics was a doomsday scenario: “fintech means the death of banks.” The idea was that startups were disrupting the traditional models, driving down costs and making complicated processes so accessible and user-friendly that they would change banking as we know it today.

That theory has not proven true. Instead, the conversation around fintech companies *replacing* banks has shifted to a discussion around those companies *partnering* with them, and in a variety of ways.

Because banking is one of our country’s most heavily regulated industries, requiring extensive licensing, permits, oversight, etc., fintech companies have found that venturing past a certain point into banking territory means more cost than benefit.

And with many fintech companies realizing that partnering with banks is more efficient than directly competing with them, mutually beneficial relationships are evolving. Through partnerships, fintech companies get the support they need from established banks with years of expertise as a regulated institution. In return, banks gain access to new customers and product offerings.

Community Banks/Credit Union - Fintech Partnerships

Banks, by virtue of their structure and regulatory requirements, serve as MSBs and are exempt from individual state Money Transmitter License (MTL) requirements. Custodial accounts that are “forthe-benefit-of” certain third-party customers have been utilized for years, with trusts and escrow accounts being the most common traditional use.

These accounts are managed by third-party service providers, who hold funds for their customers as part of their trust or escrow service. FinCEN has ruled that this type of arrangement can be exempt from MTL. Therefore, there is potential for a fintech to utilize this account structure to process payment transactions on behalf of its customers. The bank owns the account (EIN) that holds the fintechs customer’s funds, limiting regulatory risk.

In the use-case of ACH as a money movement method, payment instructions are provided to the bank from the fintech, as instructed by the individual consumer or business customers. Utilizing the FBO account structure has the effect of removing the fintech from dominion over, or access to, client funds therefore, reducing exposure to money transmission regulations.

Allison: Master Disbursement, or “FBO” As-A-Service

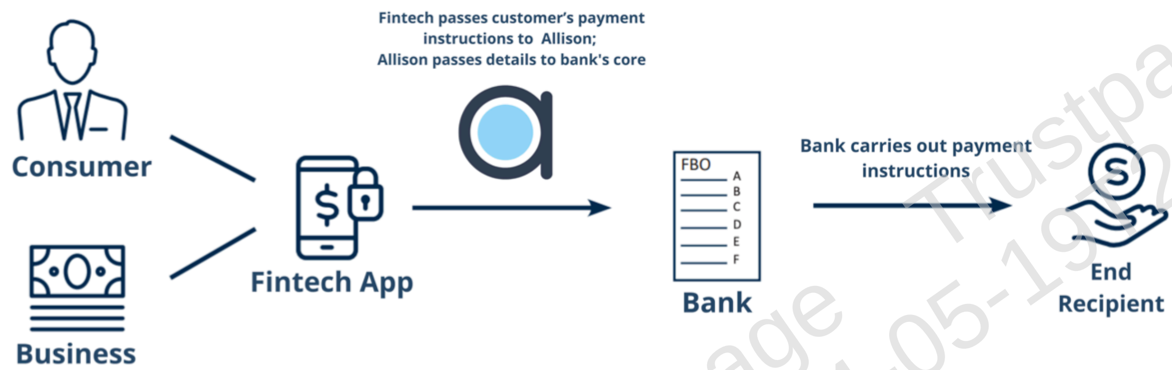
Given the heightened risk and compliance requirements, banks are hesitant to enter such arrangements with third-party providers (fintechs). And even those that do may find that their internal policies, processes and controls are not adequate for such arrangements. For example, banks must have dedicated resources for fraud, BSA/AML, Consumer Compliance, Accounting & Finance to safely manage these programs.

A failure in any of these areas can have significant consequences for all parties involved. Finding the right bank partner is key. A partner that understands the market and the operational (and creative) requirements needed for a successful relationship. Similarly, banks must ensure that their fintech partners understand the importance of risk/compliance and can demonstrate proper controls.

Benefits of Allison’s FBO-as-a-Service:

- Non-Interest Deposits: deposits from a fintech use case sit within the core of the sponsoring bank.
- Customer Confidence: funds are held by a federally regulated financial institution that provides FDIC Insurance for all account holders within the aggregated account structure.
- Increased Control and Reduced Cost: Direct access to bank partner versus an intermediary

Sample Flow of Funds: FBO-as-a-Service



Compliance monitoring is occurring throughout the process.