An Update on Alternative Lending
by Charles Wendel

In recent weeks I have attended and spoken at a number of conferences focusing on alternative lending. The most prominent of these was in New York at Lendit 2017 with 5000+ attendees.

FIC's view of the Fintech lending space has changed significantly since we first started working in this area over four years ago. From the beginning FIC's focus has been in working with banks in their selection of Fintech partners and with the Fintech companies themselves on how they can best work with banks and others to generate more and lower cost loan originations.

What is the current status of business lending-oriented Fintechs with banks?

Several speakers described 2017 as the "year of partnerships" between banks and Fintechs. However, no tsunami of activity is likely to occur. In the last few months only two significant transactions have been announced (Citibank with Biz2Credit and Citizens with Fundation).

Understandably, the bank approval process for a partnership is long. From the vendor's perspective it is sometimes torturous. Selecting a vendor includes evaluating what one banker termed "countless areas", including: information security, data security/privacy, compliance, risk management, technology, fair lending, and reputation risk, among others. The selection and due diligence process can take more than a year. That does not allow for tsunamis. It also means that Fintechs need to invest to meet bank requirements and be both patient and persistent to get deals done.

Banks need to assess why a number of transactions that were established in recent years have already been discontinued. We know of at least four that ended in the last year or so; three of these involve one Fintech vendor. In some instances the bank may not have structured their relationship with the Fintech to promote success. Bankers may have been reluctant to refer deals either because of concerns about their customer's experience and/or lack of personal incentive to do so.

As for the Fintechs, some appear unprepared to roll up their sleeves to engage in implementation and the hard day-to-day execution required to make this type of partnership succeed. Making the sales to a bank is just step one. Fintechs should be able to provide a turnkey solution that may include some hand holding to demonstrate how their digital approach results in more revenues and an enhanced customer experience.

Top management must be on board, be an active supporter of working with a Fintech, and see its value. At one recent client, the bank CEO was strongly supportive of a Fintech relationship and was involved throughout the selection process. He followed through. About 18 months ago another CEO came back from a senior banker's meeting proclaiming the need for a Fintech solution. However, until today, nothing has changed because of lack of leadership follow through. In a third case at another bank, the product people pushed for the idea with top management agreeing somewhat reluctantly to enter a pilot. Frankly, banks should not bother to go through a Fintech selection process unless management is truly on board.

The nature of what a Fintech partnership entails may be changing and may not include third-party lending. More banks seem to want a DIY approach that allows them to offer small loans more efficiently while maintaining bank control over the process. The most notable relatively small bank that has pursued this approach is Eastern Bank of Boston. Some Fintechs, like Mirador Financial, specialize in providing an origination platform that can streamline the process, reduce time to approve, and lower costs. Other companies like PayNet provide supplemental risk management information that can better inform a bank's credit decision. Using vendors like these, in a sense a bank can be its own general contractor in creating an "express loan" product.

Many lenders are segmenting their approach. Initially, third-party lenders operated without an industry focus. Now, companies like Apple Pie (franchising), Lighter Capital (tech startups). Street Shares (veteran-owned companies) and others have a niche orientation. The expertise they offer may make them sustainable for the long haul and attractive as acquisition candidates. They may also be attractive to banks wishing to target a specific segment.

Be careful. Fintech consists of supremely confident people who usually think they are the smartest in the room…sometimes they are. Banks need to work with the Fintechs that offer the most compatible cultures.

This is the start of a long game. I admit that I was one of those who thought it was going to be the year of the bank partnership, not in 2017 but in 2016. Yikes. But:

- Banks cannot be pushed to act quickly for revenue opportunities. If you are a company offering fraud prevention or compliance adherence, then, the process may speed up. Banks view working with a third-party lender as an option not a necessity.
- Banks should take the time necessary to become comfortable with a partner whom they should want to engage with for many years.
- Individual players will change: entrants and exits will speed up this year. But, the value Fintechs offer will only increase and spread from lending and platforms to areas including compliance and fraud prevention. Despite all the noise, these are early days.

Any bank that does not have an emphasis on evaluating Fintech opportunities is making a mistake. Some banks should work with Fintechs immediately whether in lending or to offer customers a digital platform. Others may need to accomplish other more fundamental tasks (for example, related to addressing organizational inefficiencies or mediocre staff) before being able to leverage what Fintech can offer. However, ALL banks should understand that Fintechs are part of the permanent landscape. In the future the best performing banks must leverage and exploit them to enhance the customer experience and grow revenues.