COALITION FOR FINANCIAL ECOSYSTEM STANDARDS

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A framework for bank–nonbank partnerships

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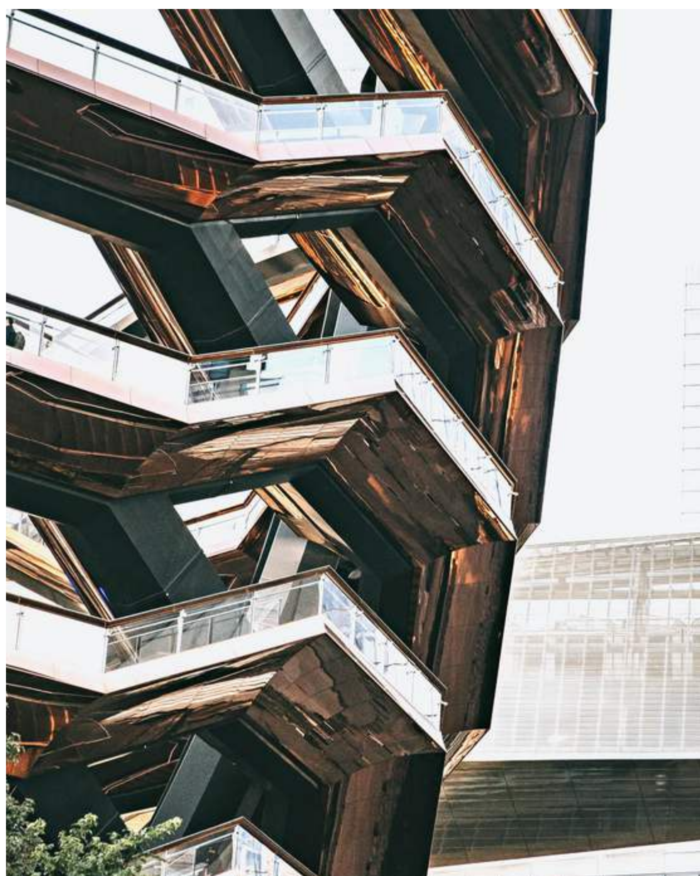


About the Coalition for Financial Ecosystem Standards

The Coalition for Financial Ecosystem Standards (CFES) is an organization that supports the compliant growth and innovation of financial services. In partnership with FS Vector and industry leaders, we are addressing one of the most significant challenges in the industry today: partnerships between banks and non-bank fintech and technology entities. These collaborations play a vital role in driving financial innovation and growth, but the lack of a clear standard for compliance rigor that safety and soundness can undermine their operational viability.

CFES aims to bridge this gap by fostering dialogue and developing frameworks that promote competition and innovation, while maintaining robust risk management and regulatory compliance. By bringing together industry stakeholders, regulators, and experts, CFES works to create an environment where financial innovation can thrive within a structure that ensures consumer protection and maintains the integrity of the financial system. Our goal is to build trust, enhance transparency, and drive efficiencies in bank-nonbank partnerships, ultimately contributing to a more dynamic and secure financial ecosystem.

I. Executive Summary

Over the past 20 years financial services underwent a digital transformation that broadly touched on product features, user interfaces, customer servicing, and more recently, even the business of partnerships. Specifically, banks via software touchpoints are partnering with nonbanks to deliver financial services and products in new ways. These collaborations, which merge traditional banking features with solutions offered by nonbank companies, are reshaping the types of products consumers and businesses enjoy, but also placing pressures on the boundaries of the financial ecosystem and regulatory oversight.

By leveraging the strengths of both traditional financial institutions and innovative technology companies, these bank-nonbank collaborations have the potential to enhance product offerings, improve customer experiences, and drive financial inclusion. However, the evolving nature of these partnerships also presents challenges. Differing regulatory requirements, complex operational and technical integrations, and sometimes varying levels of compliance culture are examples of adjacencies that may cause concern as banks continue to partner with nonbanks to grow and support the offering of financial products and services. The success and sustainability of these partnerships hinge on effectively addressing these challenges while maintaining robust compliance practices.

As these partnerships proliferate, and their influence on markets grows, regulators rightly raise questions about how best to align these products and services within the regulatory ambit. Questions about the implications of these partnerships have existed since the Office of the Comptroller of the Currency (OCC) Controller Julie Williams presciently dubbed them as bank franchise models nearly 20 years ago. While answers remain in motion, what is certain is that in many ways these partnerships are inevitable. What is equally certain is that a strong risk management culture and adherence to regulatory standards are fundamental to the long-term viability of these partnerships.

In this paper we aim to present a lexicon and common understanding for this complex and quickly evolving ecosystem. In particular, we explore:

- A survey of the products and services enabled
- Market impacts
- Implications on the regulatory framework

We close with suggested recommendations for next steps, appreciating that more collaboration and work remains necessary.

II. Survey of Structures and Models

Evolution of the Bank Franchise Model

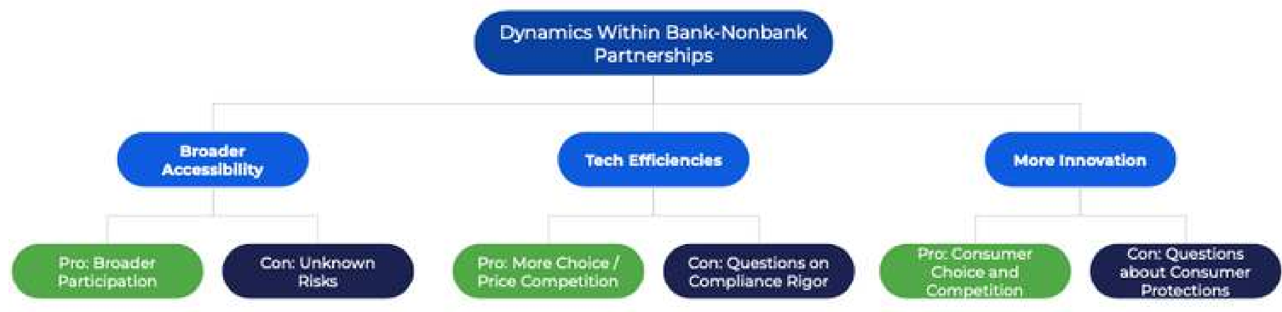
The bank franchise model, as identified as far back in 2001 by OCC Comptroller Julie Williams, initially raised concerns among regulators due to its departure from traditional banking structures.[1] Comptroller Williams noted that franchising the bank's attributes "is the newest, and potentially most problematic" type of bank partnership. She explained, "a bank is detaching its name and reputation from its own activities and permitting its attributes to be used in connection with the products and services of a third party." We know this model today as the "bank-nonbank" partnership.

WebBank, founded in 1997, was one of the earliest examples of a bank offering bank-nonbank partnerships. In 2006, it originated credit card and consumer loans for Genesis Financial Solutions. Two years later, it struck deals to originate loans for Prosper Marketplace and LendingClub, a public peer-to-peer (P2P) lending company. Over the past 20 years, this model produced increasingly mainstream products that touched upon a broader number of consumers, including: Chime, a digital-first neobank, partnering with The Bancorp Bank and Stride Bank; Acorns, a micro-investing and robo advisor, partnering with Lincoln Savings Bank; and Greenlight, a debit card for kids, partnering with Community Federal Savings Bank. This model has matured so that even public, household nonbank software companies like Block (formerly Square) and PayPal (owns Venmo) maintain multiple partnerships with banks to support various product suites.

It's important to note that nonbank partnerships touch on banks of all sizes – from community to regional to large banks. Co-branded credit cards are a more traditional example of how nonbanks like United Airlines partner with banks to "embed financial services" within their non-banking business lines (in this case, JPMorgan Chase). HSBC, for example, recently partnered with the B2B fintech platform Tradeshift and with the digital logistics company FreightAmigo.[2] The widespread nature of these models highlight the long-standing practices and industry-wide acceptance of the value these partnerships bring.

While these relationships between banks and nonbanks are not new, the diversity and speed at which these models are proliferating is new. Today's partnerships feature a broader number of banks, products, and fintechs than the prior models.

Figure 1. Dynamics within Bank-Nonbank Partnerships



Structures of Bank-Nonbank Partnerships

While the number of these partnerships has increased, so too have the variations and types of partnerships. Nonetheless, for the purposes of defining a framework that allows for examination of these partnerships, we can bucket these partnerships into two main structures. While we acknowledge that within each of these buckets there remains variation, and arguably gray areas between even the two buckets we articulate below, for the purposes of this paper we will focus on these two broad buckets:

- *Direct model.* This structure involves a nonbank partnering directly with a bank to offer financial services. In this model, the software and banking functions are tightly integrated, often minimizing the types of external partners required for delivery of the end-to-end. From a technical perspective, these relationships typically leverage either the bank's internal software layer or the nonbanks' software layer. Examples of banks that build their own connectivity layer include Lead Bank, Column Bank, and Cross River Bank. Rho and Mercury, on the other hand, are examples of nonbanks that bring their own software enabling connectivity to a range of partner banks.

  In both instances, the relationship between bank and nonbank is direct, with minimal reliance on external software providers for core services like ledgering. While this model offers greater control and customization, it often comes with higher up-front build and economic costs, making it challenging for smaller companies. Additionally, the deep integration can result in significant switching costs for the nonbank partner, potentially impacting the flexibility of the business model.

- *Enabling software.* In this structure, a nonbank partners with a bank and utilizes a third-party that provides a software layer to facilitate connectivity. These providers offer software solutions for connectivity, API layers for data exchange, and tools for transaction processing and account management. In some instances, the enabling software may integrate directly with a bank's core – mimicking the tightness of an integration in a direct model. By removing the burden of technical build from the bank and the nonbank, these software providers facilitate innovation and competition. At the same time, as a critical enabler of the services, they introduce risk vectors when neither bank

nor nonbank adequately diligence their services.

There are broadly two types of enabling software providers: program managers and non-program managers. Program managers offer compliance and other operational services in addition to technical integrations. In contrast, non-program managers focus primarily on technical integration without offering program management services. In the model without program managers, banks retain more direct control over their fintech partnerships, including compliance, risk management, and oversight duties. In this way, this arrangement looks more like a direct model except that the bank and nonbank rely on a third-party software provider to facilitate their relationship.

While these two categories provide a useful framework, the distinctions between them are not always clear-cut, and some companies may operate across multiple categories. In fact, many fintechs employ a combination of models – delivering some products through enabling software while others are delivered through direct models. The fintech ecosystem is dynamic, with companies often evolving their partnership models over time.

Regardless of which category a partnership falls in, the ending of a partnership and the provision of related services requires planning. Consumer protections must be paramount: minimizing disruptions and preserving access to funds. In some cases, nonbanks can transition services and products to an alternative bank partner, but in many cases, the costs associated with such a transition can be a company-ending event. Stability in these partnerships, across categories, is important for customers, competition, and stability of the ecosystem broadly.

End-user relationships in bank-nonbank partnerships

Consumer protections around financial services must remain paramount, regardless of the structure in which financial services are offered. Although products delivered through bank-nonbank partnerships are often accompanied with clear disclaimers,[3] consumers may believe they are interacting directly with a regulated bank and benefit from the attendant protections.

For Federal Deposit Insurance Corporation (FDIC) insurance to flow through bank-nonbank partners in a manner that consumers may expect should they be banking directly with a bank, the ledgering between bank and nonbank must be precise and transparent. And in the case of a software enabled relationship, that match must extend to the third-party. Failure to reflect clear flow of funds, comingling of operating and consumer accounts, and out of sync books across any parties can result in a loss of protection. The involvement of third-parties by itself is not problematic – the traditional reliance on cores and other critical infrastructure players provides precedent for these types of models. However, these players and the systems on which they rely must adopt a strong culture of compliance and accounting in order to ensure that consumer protections remain intact.

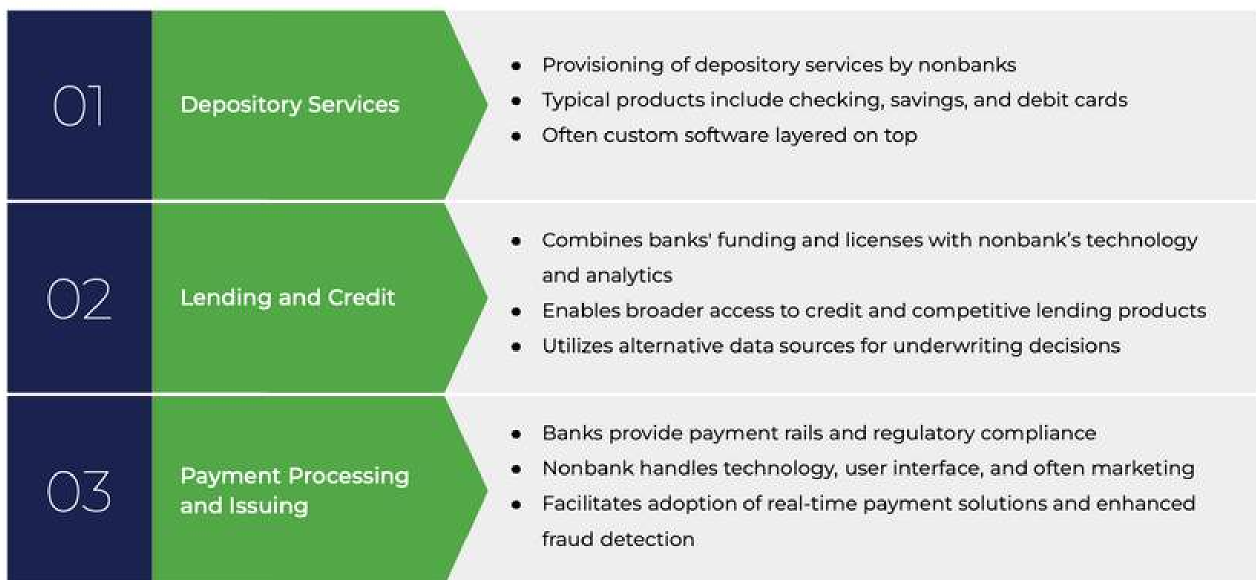
Delivery of products and services through partnerships

While the structures of bank-nonbank partnerships can vary (eg., direct vs. enabling software), so too can the services and products delivered through these structures.

- Depository Services [4]
- Lending and Credit
- Payment Processing and Issuing

Part of the complexity in the system rests in the various approaches even a single nonbank may adopt to deliver services and products. For example, a nonbank as it seeks product-market fit may leverage a enabling software approach but as it matures, may grow into a direct model for its products while continuing to leverage enabling software for issuing its cards. This fluidity continues to evolve as business models and technology adapt. It's also worth noting the emergency of other categories, including Open Banking, that may further add complexity to the relationships between banks and non-banks.

Figure 2: Types of Bank-Nonbank Partnerships



III. Market Impacts on Banks

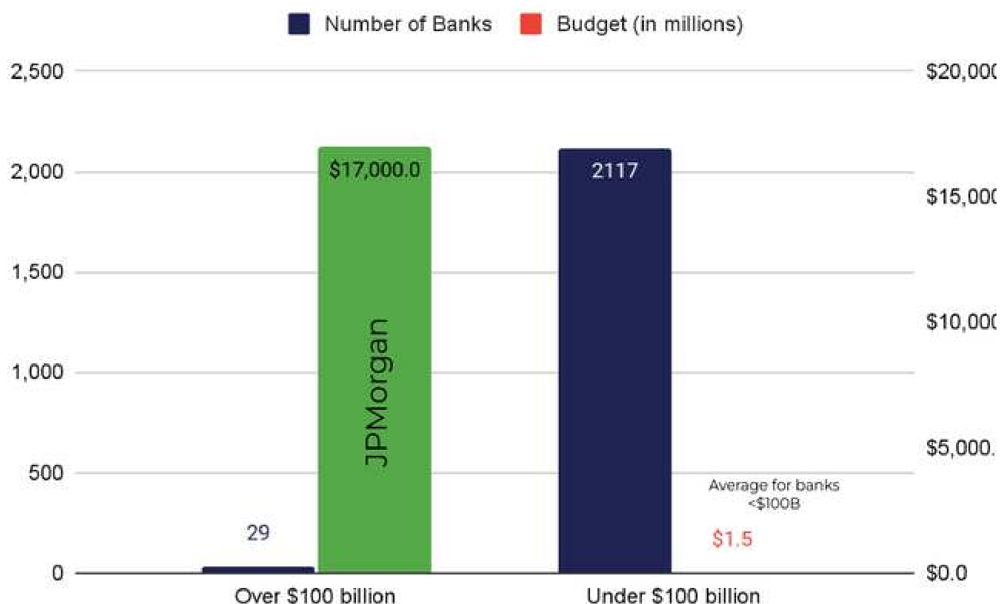
The digital push within banking over the past two decades reshaped products, customer servicing and experiences. And as described in Section II, it is also reshaping bank partnership models. In this section we explore how digitization is changing business models. It enables consumers to bank from anywhere – local is not necessary. What's more, the software underpinning digital experiences favors business models that scale. While banks across the industry were impacted, arguably the most challenged business models are those of the community banks.

Software favors economies of scale

The rise of software-driven models shifted banking operations and consumer expectations from local to digital. Digital banking, mobile apps, and automated services are increasingly the norm. This shift is evident in the sharp increase in mobile banking usage: from 15.1% in 2017 to 34.0% in 2019, and further to 43.5% in 2021, becoming the most prevalent primary method of account access.[5] A common level of up-front and ongoing investment to enable mobile functionality is required, regardless of scale. These expenses are largely independent of customer utilization, meaning for a given level of functionality, fixed costs are agnostic of customer base. As a result, banks with bigger customer bases stand to win – realizing a larger margin on their technology investments.

Ultimately, software favors economies of scale, resulting in consolidation of smaller banks so they can compete, while providing large depositories with a structural advantage over smaller community banks. Large banks with the ability to reinvest returns into their tech stack can further grow

Figure 3: Number of Banks and Technology Spend by Bank Size



their customer base, widening the disparity over time. At its extreme, one can look at JPMC's tech spend of $17 billion in 2024 alone, compared to a median of $1.5 million by banks below $100 billion in assets.[6 7]

Consolidation and Impact on Community Banks

The growth of digitization and the importance of software in banking over the past 20 years correlated with consolidation within community banks. The number of FDIC-insured banks decreased from over 8,300 in 2000[8] to less than 4,600 in the first quarter 2024 – a near 50% decrease in the number of banks.[9] This trend predominantly impacted smaller community banks (<$10B in assets), while larger institutions (>$10B in assets) actually expanded their market share over the same time period.

Market impact of bank-nonbank partnerships

In the face of structural market challenges, community banks have increasingly turned to partnerships with nonbanks for growth. While, as noted above, many types of partnerships exist, data collected on the impact of bank-nonbank partnerships likely indicates broader trends. Community banks participating in bank-nonbank partnerships outperform their peers in both deposit and lending growth – more deposits means more capital available to lend. In Q2 2023, banks engaged in fintech partnerships saw a median sequential deposit growth of 2.2%, while other U.S. banks with assets under $10 billion experienced a 0.8% decline.[10] Furthermore, community banks engaged in bank-nonbank partnerships also outperformed their peers in loan growth rates in Q1 2023, with a median quarter-over-quarter growth of 3.36%, while community banks not offering bank-nonbank partnerships grew by only 1.22%.[11 12]

While still early days, these data points suggest that the bank-nonbank partnership model is providing a competitive advantage to community banks, enabling them to attract and retain deposits more effectively than their traditional counterparts. Some reports suggest the market itself could grow to more than $25 billion in annual revenue in 2026.[13] Even larger institutions are recognizing the value of these partnerships and making strategic moves in this space. In 2023, two significant acquisitions highlighted this trend: Fifth Third Bank acquired Rize, a enabling software player, to become an integrated player; similarly, FIS acquired Bond, a enabling software player, to expedite its entry into the space. These acquisitions by larger players suggest a growing importance of bank-nonbank partnerships across the entire banking spectrum, not just for community banks.

It is worth noting that these partnerships come with economic costs that are necessary to make them viable. These costs include investments in technology, regulatory compliance, and integration processes. However, as seen in The Bancorp Case Study, the benefits can outweigh these initial expenses, especially when undertaken with appropriate risk management frameworks and compliance cultures. Ideally, market maturity and greater certainty over sustainable practices can help increase transparency and absorb cost inefficiencies to make it more efficient.

Case Study: The Bancorp

The Bancorp provides a compelling example of how a bank can leverage bank-nonbank partnerships to achieve significant growth and profitability. Founded in 1999 as a traditional commercial bank, The Bancorp evolved into a key player in the fintech space, particularly in prepaid cards and payments services. Despite facing regulatory challenges in 2014, including a six-year process to resolve an FDIC consent order, the bank used this experience to develop a strong culture of compliance, which it now views as a competitive advantage. By focusing on partnerships with major fintech companies like PayPal, Venmo, Chime, and SoFi, The Bancorp processed over $100 billion in card spending in 2021, rivaling the transaction volumes of much larger banks.

This strategy yielded results for The Bancorp. From 2016 to 2021, average deposits grew from $3.8 billion to $5.7 billion, while the cost of deposits decreased from 30 basis points to 10 basis points. The bank's payments income grew from $60 million in 2017 to $82 million in 2021, now comprising 26% of total income. By focusing on operational efficiency and scalable technology, The Bancorp drove down its efficiency ratio to near 50% and increased its ROE from 15% in 2020 to 18% in 2021, with a long-term target of 22%. The Bancorp's success demonstrates the potential of bank-nonbank partnerships when executed with a focus on operational excellence, compliance, and strategic partnerships, while also highlighting the complexities and regulatory challenges that banks must navigate in this space.

IV. Regulatory Activity

The lines between bank and nonbank entities are becoming increasingly blurred, raising important considerations about regulatory oversight, risk management, and consumer protections. FDIC Chairman Martin J. Gruenberg noted, "bank–like services operated outside the regulated banking environment, such as those just described, can pose opaque risks and interconnectedness that could adversely affect the safety–and–soundness of banks or result in consumer harm." [14]

Regulators have long used TPRM frameworks to enable safety and soundness within the banking system. The relative newness yet evolving complexity of bank-nonbank relationships raises questions about how best to apply the TPRM.

Third-Party Risk Management (TPRM)

TPRM is the regulatory framework used to oversee and mitigate risks in banks' relationships with external parties, including fintech partners. The Federal Financial Institutions Examination Council's (FFIEC) guidelines provide a foundation for this approach, advocating for proportional risk management that scales with institutional size and risk level. As the guidance states, "Not all relationships present the same level of risk, and therefore not all relationships require the same level or type of oversight or risk management. As part of sound risk management, a banking organization analyzes the risks associated with each third-party relationship and tailors risk management practices, commensurate with the banking organization's size, complexity, and risk profile and with the nature of the third-party relationship."[15] This approach leaves space for newer players and innovation by suggesting proportionality based on the institution's size, complexity, and risk profile.

While this framework has long applied to evaluating bank-nonbank partnerships and in particular vendor models, its application to newer, more complex fintech collaborations raises questions.

The lack of established practices around the aforementioned creates a sense of trepidation among banks, their boards, and partner fintechs – that even when compliance is paramount, that concomitant investments will not be sufficient. In July 2024, the FFIEC agencies released additional guidance to help inform banks' arrangements with third parties to deliver bank deposit products and services to end users. However, the relative newness of the ecosystem and its constantly evolving nature, leaves more room for interpretation even around these more comprehensive guidelines.

Increased Regulatory Activity

In the first half of 2024, there were 46 formal enforcement actions brought by the federal banking agencies (OCC, Federal Reserve, and FDIC), with almost 24% of them received by partner banks engaged in bank-nonbank partnerships. The number of formal enforcement actions brought against these banks showed heightened regulatory

scrutiny of bank-nonbank partnerships.

On July 25, the agencies released a Joint Statement highlighting that "the agencies have observed an evolution and expansion of these arrangements to include more complex arrangements that involve the reliance on third parties to deliver deposit products and services."[16]

While the governance framework provided by the FFIEC holds true, what remains inchoate is its application to these newer models. Arguably, the fact that a larger proportion of regulatory actions relate to these bank-nonbank partnerships reflects the growing prevalence and complexity of these arrangements in the financial services sector, and the need for more structured rigor around the application of third-party risk management frameworks.

FFIEC Investments in Fintech Expertise

In light of the rapidly evolving nature of software and technology in the financial sector, regulators and bank examiners are investing in training and resources to help them understand how these developments impact safety and soundness. A recent Government Accountability Office (GAO) report highlighted this need for specialized expertise among examiners to effectively understand and evaluate cutting-edge financial technologies.[17] And indeed, within the past two years, both the OCC and FDIC posted openings for senior experts that would facilitate in-house expertise. More recently, along with the Joint Statement, the FFIEC agencies released a Request for Information (RFI) to further educate themselves on the evolution of these partnerships and their implications.

Ongoing hiring, RFIs, and continued dialogue makes sense given the continuous nature of technology.

V. Recommendations: Maturing Bank–Nonbank Partnerships

In Section I, we noted that bank-nonbank partnerships are markedly diverse in their structures, and in the types of products and services they facilitate. In Section II, we explained that at their best, these partnerships enable community banks to compete and maintain relevance, offering consumers and small businesses greater product choice and competitive pricing. And as we discussed in Section III, despite these benefits, it's clear that the complexity and continuously evolving nature of these relationships strain regulators' abilities to preserve safety and soundness, and ensure the appropriate consumer protections.

This paper is but one step in the direction towards developing a more common lexicon and understanding of this uniquely complex and multifaceted financial ecosystem. What is clear, however, is that this ecosystem will continue to develop and that partnerships with banks will continue to foster the expansion of financial services. Without intentionality, an emphasis on compliance rigor without clear guidelines and targets can come at the expense of competition and innovation – shifting greater market share to the larger institutions. Similarly, an overemphasis on innovation can come at the expense of compliance, risk management, and consumer protections. A balance is ideal, but that can only be achieved with intentionality.

In this spirit of achieving a balance, we recommend a few next steps:

- **First, a continued dialogue to foster a deeper and more common understanding around bank-nonbank partnerships.** An advisory group with a formal communication cadence could be a helpful tool for fostering the exchange of interdisciplinary expertise between regulators and experts across tech, financial services, and compliance and risk management. It can also facilitate greater access to resources and expertise by regulators and examiners on the forefront of understanding the implications of these partnerships on the broader ecosystem.
- **Second, while safety and soundness, along with consumer protections must remain paramount, so too must an intentionality around protecting competition.** Software and the continued digitization of financial services places pressures on community banks, which have long served as alternatives to the big banks. Regulators and industry participants just partner to flesh out a risk-based proportional approach towards third-party risk management that supports and enables community banks to innovate through partnerships, while staying true to the FFIEC's TPRM guidance. Intentionality in policy making will be required to protect the innovative and competitive elements these community banks and their partners provide in the market, while preserving compliance and risk management considerations.

- **Third, as nonbank partners continue to offer financial services, these nonbanks should also be accountable for protecting the financial industry.** Industry needs to be a part of the dialogue around compliance and risk management practices to support their partner banks. As the complexity and interconnectedness of these partnerships evolves, nonbanks should consider adopting a more clear role, including standards and/or certifications, to increase rigor around compliance, risk management, and consumer protections.

Endnotes

1. OCC. Remarks by Julie L. Williams. (2001).

2. McKinsey & Co. Embedded finance: The choices and trade-offs for US banks. (2024).

3. The industry standard for Company X partnering with Bank Z typically looks like "X is a financial technology company, not a bank. Banking services provided by Z Bank, N.A.; Member FDIC"

4. For clarity and consistency, this paper intentionally avoids the term Banking-as-a-Service (BaaS) due to its varied interpretations. In some discussions, BaaS refers to the provisioning of depository services while other groups use BaaS to mean a broader set of relationships synonymous with bank-nonbank partnerships. Usage of ambiguous lexicon exacerbates the discussion around what is already substantively complex, and so for the sake of clarity, we avoid the use of BaaS.

5. FDIC. 2021 FDIC National Survey of Unbanked and Underbanked Households. (2021).

6. JPMorgan. Investor Day 2024 Firm Overview. (2024).

7. Bank Director. 2023 Technology Survey. (2023).

8. FDIC. Stats at a glance. (2001).

9.FDIC. Statistics At A Glance (2004).

10. S&P Global. Banking as a service still boosts banks' deposits but has its risks. (2023).

11. S&P Global. Banking-as-a-service providers grow deposits despite Q1 turmoil. (2023).

12. This data from Q1 and Q2 2023 is the only available information at the time of writing. However, these quarters may not represent long-term trends due to exceptional circumstances, including the Silicon Valley Bank failure in March 2023 and subsequent deposit volatility.

13. Cornerstone Advisors. Banking as a Service: Banks' $25 billion revenue opportunity in fintech banking. (2022).

14. FDIC. Remarks by FDIC Chairman Martin J. Gruenberg. (2023).

15. Federal Banking Agencies. Interagency Guidance on Third-Party Relationships. (2023).

16. Federal Banking Agencies. Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services. (2024).

17. U.S. GAO. Financial technology: Agencies can better support workforce expertise and measure the performance of innovation offices. (2023).

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