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Can BaaS Deliver ROI for FIs?

Proven steps from financial leaders who are paving the way

Banking-as-a-Service (BaaS) and embedded finance are among the key topics of discussion across the financial services industry as the use of mobile and digital banking services increases rapidly.

In fact, revenue generated from embedded financial services is expected to exceed $183 billion globally in 2027—roughly a 180% increase from 2022. Embedded finance is a key component in the future of BaaS as it represents a $7 trillion opportunity.

BaaS allows FIs to play in more spaces than ever before, touch new industries, become part of a bigger ecosystem, and reach customers they hadn't been able to in the past.

30%

Given the potential to drive real revenue for FIs, BaaS is expected to mainstream within two years, with 30% of major banks (those greater than $1B in assets) launching a BaaS solution by the end of 2024.

But ask 100 financial leaders for a definition of BaaS and embedded finance and you might get 100 different answers. American Banker recently did just that. In a survey of bank and credit union leaders with deep knowledge of their FIs' new business areas or customer engagement initiatives, they found a wide range of knowledge, strategic plans, and prioritization of BaaS.

Among respondents, while 43% were familiar with a commonly accepted definition of BaaS (more on that below), nearly a third (32%) of respondents had "no knowledge of BaaS," and the remaining 25% had an incorrect or incomplete definition.

Despite these limitations, the industry is making progress, both in aligning around a commonly accepted definition, and, in some cases, strategic prioritization of BaaS and embedded finance as promising growth strategies.

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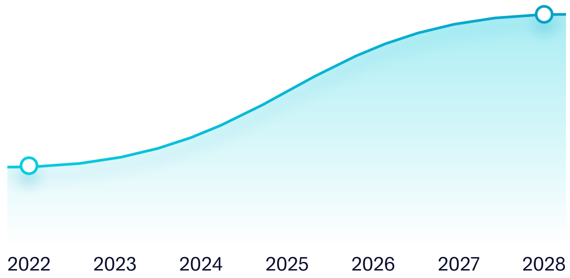


FI Leaders' Knowledge of BaaS

Familiar with a commonly accepted definition of BaaS	43%
No knowledge of BaaS	32%
Incorrect or incomplete definition	25%

Why is BaaS at the center of many discussions among FIs today?

BaaS helps banks and credit unions maintain a competitive position and opens new distribution channels that allow them to reach new customers – both through non-bank businesses and, somewhat ironically, also through fintechs.

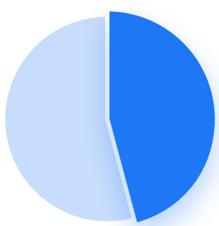
As FIs are beginning to realize this growth opportunity, they are at various stages in understanding, prioritizing, and going to market with BaaS strategies. The American Banker report looks at how FIs across the country are approaching BaaS, what obstacles are causing the biggest problems, and what it takes to deliver a successful BaaS strategy.

For the purposes of this playbook, we define BaaS and embedded finance as follows:

BaaS is a partnership model under which a fully licensed bank partners with a non-bank or fintech to sponsor its programs. The sponsor banks are tasked with supervising a non-bank or fintech's programs and ensuring they comply with all applicable laws, which includes overseeing and implementing compliance measures. In this model, banks allow access to its core systems and regulated infrastructure via application programming interface (API). Through this model, non-bank partners are able to offer financial products and services – such as payments, deposits, accounts and more – through its licensed bank partner.

Embedded Finance: Any use case where financial services tasks, such as payments, banking, insurance or lending, are embedded in non-financial user experiences.

84% of the financial leaders surveyed by American Banker agree that BaaS represents a new model for FI revenue growth and profitability.



Enabling BaaS capabilities is critical or high priority for nearly half (46%) of the FI leaders in the survey.

Higher-level financial leaders are most likely to prioritize BaaS, with 62% saying BaaS is a high or critical priority this year.

Why are some FIs putting BaaS on the back burner?

BaaS is a key piece of the digital transformation puzzle, so why are some banks and credit unions not prioritizing the switch?

Budget and perceived lack of ROI are the two biggest factors, with 72% of institutions that have not prioritized BaaS citing these as top obstacles. More than two-thirds (64%) of these institutions also say there's a lack of interest for non-FIs to offer banking services.

But for the 37% of respondents who say they wouldn't know where to start in pursuing a BaaS strategy, there's much more to understand. Let's start by looking at their counterparts that are embracing BaaS as a key growth strategy.

What's different at FIs that have (or are working on) a BaaS strategy?

FIs that are prioritizing BaaS have a very different strategic mindset than those who are not. They see BaaS as more of an opportunity than a distraction or a threat – especially when it comes to remaining competitive and opening new revenue streams.

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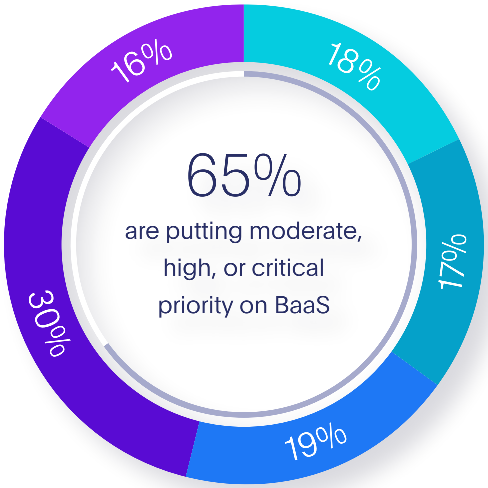
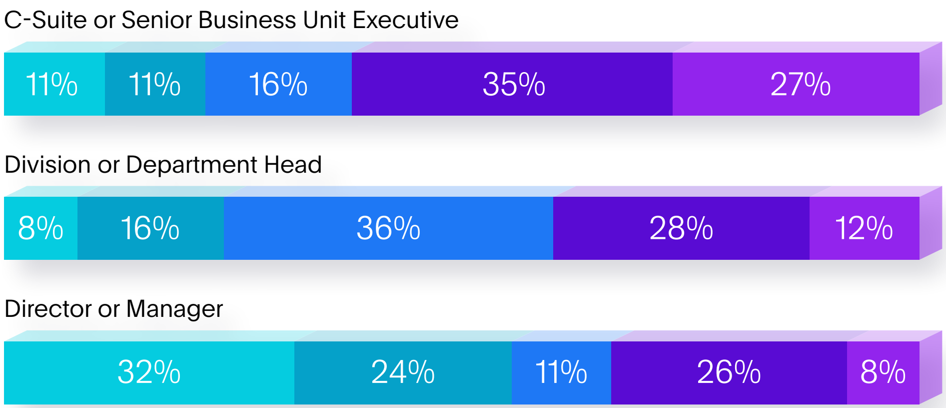
What level of strategic priority is your institution placing on BaaS capabilities to distribute banking services to non-bank companies?



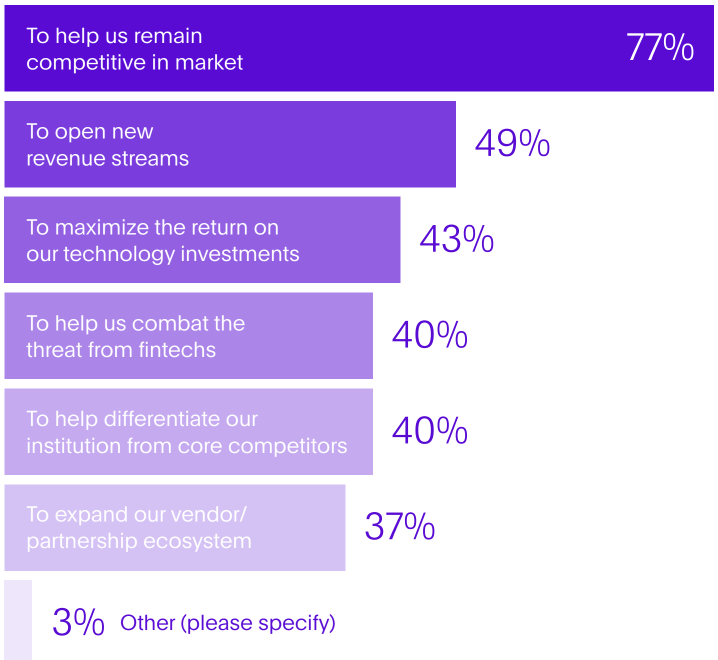


- Not a priority
- Low priority
- Moderate priority
- High priority, but not a critical priority
- Critical priority

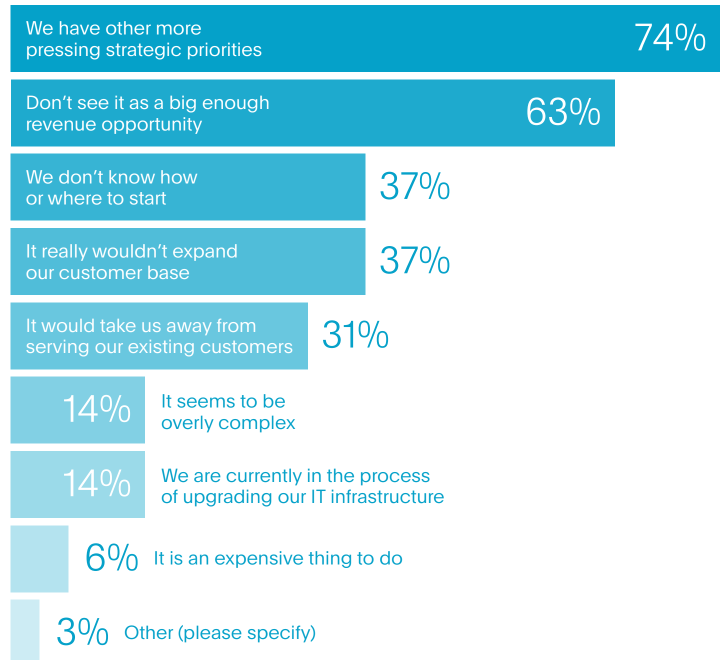
Because many FIs don't fully recognize the potential of BaaS, there is a significant competitive advantage for FIs already pursuing a BaaS strategy. As American Banker points out: "Senior leaders and those familiar with BaaS understand the risk of standing still."

For institutions prioritizing BaaS, 77% of FIs say remaining competitive in the market is the number one driver, while those who aren't prioritizing BaaS say they have more pressing strategic priorities.

Why is your institution prioritizing BaaS?



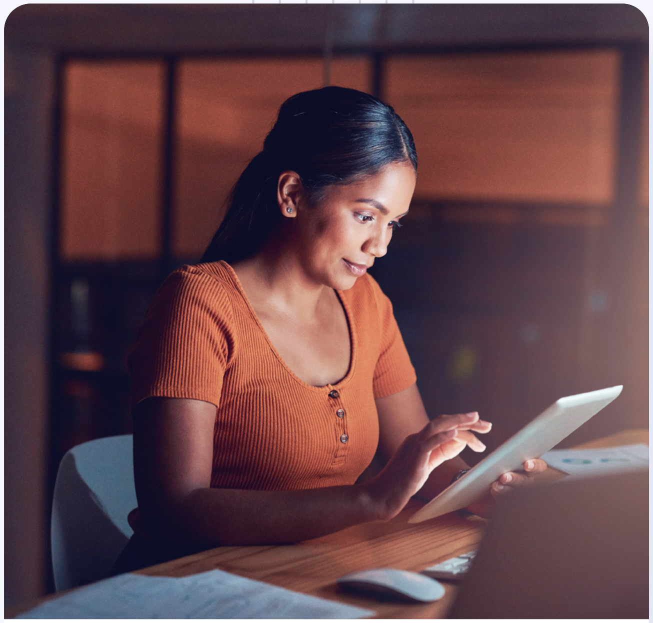
Why does your institution place such a low priority on BaaS?



All FIs still have concerns and challenges to navigate when deciding how to implement BaaS best, even when it's a top priority. Competing strategic priorities are delaying BaaS adoption across 52% of FIs, and complexity in the implementation process is a barrier for 47% of FIs.

Across all FIs – regardless of BaaS implementation status – security concerns are the top "deal breaker" that would make a financial leader walk away from a technology or fintech partner.

Interestingly, insufficient budgets are an issue for 38% of all FIs, but also varies drastically by FI size. More than half (53%) of global and national financial leaders cite budget issues as one of the biggest obstacles in advancing BaaS strategies. By contrast, only 27% of regional and community banks and 13% of credit unions say that budget is one of the biggest obstacles.



49% of c-suite and senior unit exec level respondents

in the American Banker study say implementing a next-gen core platform to make real-time data accessible and actionable is a top IT priority this year

Proven strategies to get ROI from your BaaS solution

Despite these obstacles, many FIs have successfully embraced BaaS and are seeing it pay off. What can we learn from financial leaders that have already enabled a BaaS solution or taken it on as a top strategic priority? Let's look at four proven strategies that can help FIs bet on BaaS in a way that will deliver results.

STRATEGY 1

Evaluate your technical readiness and choose the digital transformation plan that fits

Review your institution's technical capabilities, resources and needs and choose the right digital solution that aligns with your goals.

Many FIs have expressed they "don't know where to begin" when approaching a BaaS strategy. Our pro tip: Begin from within. FIs who've gone to market with BaaS started with an honest evaluation of their technical capabilities, needs and strategic priorities. Knowing your appetite for implementing BaaS requires mapping out your key goals so you can build a playbook that helps you measure success along the way.

This process leads many FIs to confirm how and why it's time to invest in a next-gen core platform to secure the future of their enterprise. In fact, nearly half (49%) of c-suite and senior unit exec level respondents in the American Banker study say implementing a next-gen core platform to make real-time data accessible and actionable is a top IT priority this year.

Before we dive into how FIs can implement a next-gen core, let's briefly look at what next-gen means and why it matters.

What is a next-gen digital core?

Next-generation banking platforms have a microservices-based architecture, are cloud-native, and are API-centric. They form the foundation of digital banking, which is built on better access to usable data so that FIs can better understand and respond to changing customer needs and personalize every experience.

A true next-gen digital core is specifically designed to adapt to the future of digital banking. Beware of legacy platforms that have taken on a series of updates and claim to be "next-gen" but are truly not. These often use closed and proprietary frameworks, meaning changes take months, and FIs are left without control over the customer journey.

Best-in-class digital banking platforms also allow FIs to get "off-the-shelf" capabilities into market relatively quickly and the flexibility and scalability to tailor or extend those offerings based on their individual market needs.

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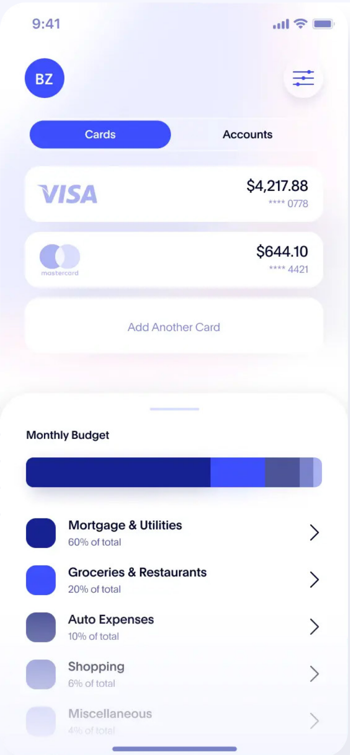


Implementing a next-gen core

FIs on a legacy core today don't have a top-notch end-user experience that they can tailor to meet customers' needs, which is why it's no surprise that the ABA Banking Journal recently noted this challenge: "In 2022, many banks experienced major customer service challenges from their core providers. Frustration with cores continues to simmer, with half of the banks with two to four years left on their core contract considering a conversion."

Costs to maintain technology systems are increasing. Managing existing systems to meet modern demands depletes FIs' already tight margins. FIs need a modern digital core and an established third-party financial technology partner to enable BaaS capabilities, but that doesn't mean your institution must completely rebuild its core. Doing so can put short-term pressure on ROI and can disrupt operations and the customer experience.

Instead, FIs looking to be successful in implementing BaaS should move forward in a way that is financially consumable for their organization. This starts with taking a hard look at your business goals, implementation timelines, data strategy and technology needs. Pro tip: Keep your customers at the heart of your decision-making process. How will your digital innovations benefit your customer? Establishing that foundation helps you know the right questions to ask to determine how your organization can maximize value from a next-gen digital core.

Regardless of the path chosen, the process requires full internal buy-in before committing. Like any technology investment, those who dedicate adequate effort reap the benefits.

Luckily, there are flexible approaches to match your FIs appetite.

FIs who want to enable new capabilities relatively quickly but have lower risk tolerance and want to avoid a wholesale migration of accounts and data from the existing core can choose core augmentation – also known as "greenfield" or a "sidecar." In this scenario, FIs continue to use their legacy core for the general ledger and system of record but enable new services and integrations on the next-gen core.

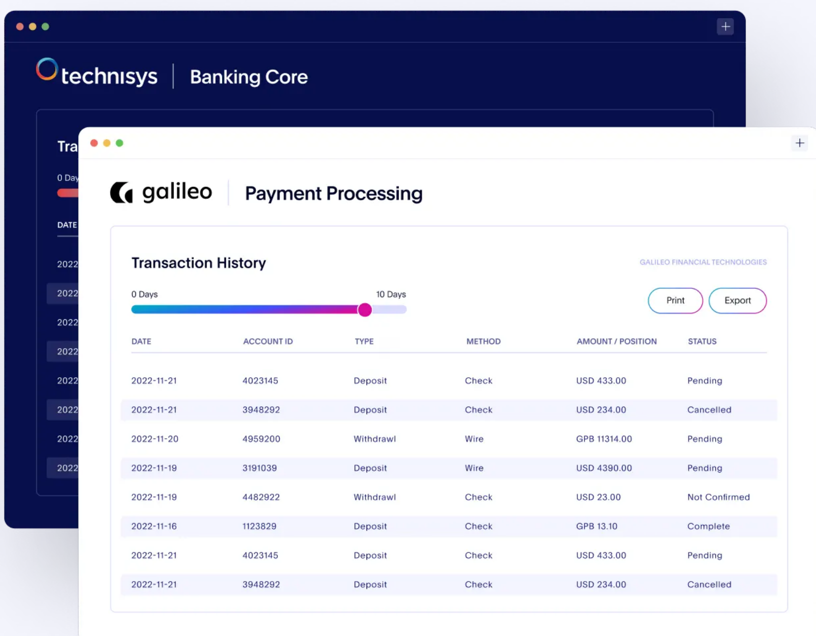
This is achieved by launching a new digital core that runs parallel to your legacy core and then launching new financial products and services or even an entirely new brand, on the new core. Once the FI has confidence that the parallel core is stable, compliant and is delivering on the revenue strategy, you can evaluate your appetite and ability to migrate data and customers to the new core gradually.

Sometimes referred to as "big bang" or "rip and replace," full core replacement means the old core is fully decommissioned at the end of a transition. This process can take a year or more for even the smallest organizations, even if they have fewer customer accounts to convert and fewer ancillary systems to integrate into the new core.

FIs who can manage a larger up-front investment and have determined that the benefits of moving entirely to a new core outweigh the risks may opt for this approach. This may be the case when the legacy core is no longer able to reliably serve the FI's existing or future customer base.

Larger FIs may take a modified big bang approach, gradually moving accounts and systems to the new core and only sunsetting the old core after many years of transition. This naturally has a negative effect on the initial ROI of the new core but offers benefits in other areas, such as stability, compliance, and more time built in for parallel testing to ensure new technologies are launched without glitches that might disrupt the customer experience.

There is no one-size fits all approach for every bank or credit union; you must decide which approach matches your organization's needs. Knowing what to look for in a solutions provider and how they can help you achieve your goals can help you decide the best approach.



For FIs that choose to modernize operations to leverage flexible and powerful API-based technology to enable BaaS, there are several top factors that FI decision-makers find especially important when choosing a solution provider:

88% say it's critical to choose a provider that has a proven, fully integrated, end-to-end platform

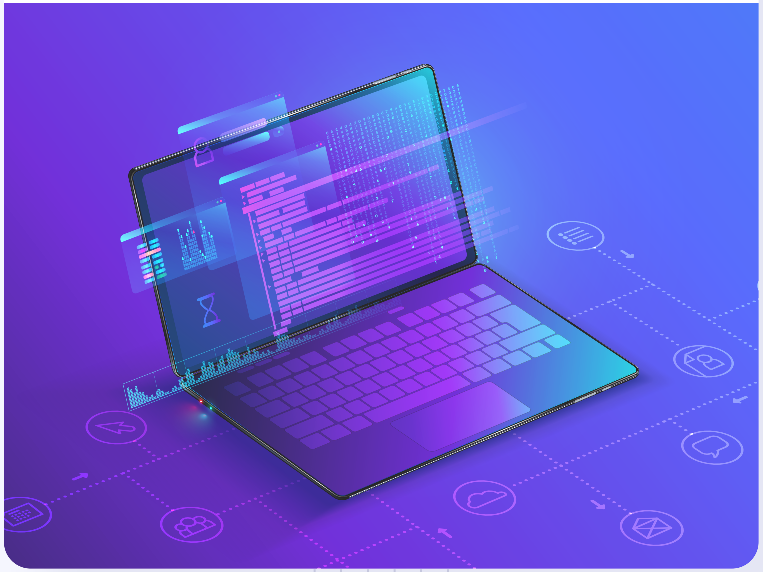
83% look for strong knowledge regarding industry regulatory compliance

77% want proven, high performing technology solutions

66% want to be able to support implementation/integration with minimal staffing support from their financial institution

61% of those surveyed have already used BaaS to drive new revenue and remain competitive

Using a cloud-native, API-centric digital banking platform, FIs can dynamically create and deliver tailor-made financial products and services to one customer – or many – and provide meaningful recommendations to customers in any channel on any device.



STRATEGY 2

Pair data with technology to monetize your BaaS investment

Embrace a data strategy that informs priorities and puts FIs back at the customer's point of need.

Driving new revenue sources and remaining competitive remain key objectives for institutions with BaaS already in practice. In fact, 61% of those surveyed have already used BaaS to achieve both of these goals.

A smart data strategy plays a major role in this success story.

No matter who the end-user belongs to – a FI or a non-FI business – FIs who maximize ROI in BaaS are approaching the opportunity with a well-composed digital banking strategy. Knowing how to access and analyze valuable data, combined with modern digital banking technology, gives FIs the flexibility and deep insights to act on those findings.

When FIs have real-time customer insights, they can make more informed decisions, and prioritize time and resources to focus on personalized financial products and services that delight current customers, while growing their addressable market to capture new revenue.

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To recap, this one-two punch of real-time data collection and analysis and the digital banking capabilities to respond quickly allows FIs to:

- Deliver more engaging customer experiences, improve personalized offers and identify new sales opportunities
- Remain competitive by offering personalized financial products and services to business customers and end-users in a myriad of new markets
- Quickly adapt end-user services to be responsive to constantly evolving customer needs
- Seamlessly onboard new and existing customers within minutes online
- Expand your FI's digital distribution, improve product quality and lower customer acquisition costs

Solutions that put financial services at the customer's point of need:

BUY NOW PAY LATER (BNPL)
Consumers can pay online or in-store. Right from an app on their phone. Get what they want now and pay over time.

EARLY WAGE ACCESS
Users can access their earned wages to their financial account, card, or pick up cash at any time.

OPEN FINANCIAL ACCOUNTS
Gig workers can receive earnings once (or more) per day.

ROUND UP
Consumers can use round-up savings, where their purchases are rounded up to the next dollar, to help them save more money by depositing it in a savings or investment account.

STRATEGY 3

Embrace conversational AI to reinvent the customer experience at scale

Whether they're pursuing a BaaS strategy or not, 70% of the FIs in the American Banker study say that adopting "smart" AI technology to improve customer experiences is a top three priority in 2023. These FIs understand that elevating the customer experience and driving engagement is one of the key elements of delivering BaaS.

While a new modern core delivers many benefits already noted above, FIs can elevate customer engagement further with AI-powered conversational banking.

Conversational AI is not a chatbot. It's a more sophisticated technology – known as an "intelligent digital assistant" (IDA) – that understands customer sentiment and intent, responds like a human, and reflects your brand persona.

IDAs recognize voice and text, decipher different languages, and know when to provide AI or human-based support for every customer engagement. AI-powered conversations are a win for customers and FIs:

CUSTOMER BENEFITS

- Connects customer to a live agent in real time, when appropriate
- Eliminates frustrating menu trees
- Enables customers to communicate in their own words
- Reliable customer support, 24/7

FI BENEFITS

- Increases customer engagement
- Reduces call center overload
- Integrates into all service channels
- Handles transactional or data-driven tasks
- Informs decision-making in real time
- Expands reach via integrated ecosystems
- Learns and improves with every customer interaction

CYBERBANK KONECTA AT WORK:

A major North American bank implemented Cyberbank Konecta starting with 200 most commonly used phrases and/or questions as part of their initial launch. As customers increasingly engaged with the bank via the IDA (intelligent digital assistant), the AI-engine continued to learn, refine and quickly expand its library of responses by **10x**. Ultimately creating positive and memorable customer experiences, while **reducing back-office calls by 70%.**

Enabling BaaS means doing so in a secure, sustainable way that minimizes disruption to a FI's business, can co-exist with current operations and doesn't put FIs out of compliance.

STRATEGY 4

Evaluate your own approach to risk management, then evaluate the market

Enabling BaaS means doing so in a secure, sustainable way that minimizes disruption to a FI's business, can co-exist with current operations and doesn't put FIs out of compliance. Anyone who has been in the industry for a long time knows this is an increasingly complex and constantly moving target.

FIs have spent endless time and resources on achieving compliance. Even the most promising growth and revenue opportunities are tempered by the risk of falling out of compliance, sustaining a security incident, or disrupting customer accounts.

While financial leaders know they must modernize the tech stack to gain a competitive edge and help ensure long-term endurance, they must also ensure they can maintain regulatory compliance as they implement these new systems. It's essential that a core banking platform powering that experience is backed by the latest regulatory compliance standards.

The conversations on keeping up with today's digital transformation have been centered on time, expense and risk of disruption, but FIs must evaluate their own risk tolerance and ensure they have a partner that can help them maintain regulatory compliance as they implement these new systems.

More than ever before FIs have a powerful opportunity to do more to deliver trusted, secure, flexible and tailored financial offerings for their customers—all while maintaining compliance. The first step is deciding which technology matches the unique needs of the FI and their customers.

About Galileo Banking-as-a-Service Capabilities

Galileo's BaaS offerings bring together the critical elements FIs need to stand up a cloud-native digital banking solution. Starting with a robust multi-core banking platform with integrated payment processing, Galileo BaaS delivers the data and core banking capabilities FIs need, along with a modern card issuing platform and the technical operations and services essential to launch and scale faster.

Next-Gen Digital Banking Platform

CYBERBANK CORE

The API-centric and microservice-based back-end technology that FIs need to power everything from account opening to mobile banking apps and deposits. This one-of-a-kind digital banking backbone enables FIs to augment or replace their old core banking systems and dynamically create and deliver tailored financial products and services based on individual customer needs and behaviors.

CYBERBANK DIGITAL

Build exceptional, empathic customer-centric experiences at every touch - enabling financial products and services to be delivered through a FI's existing digital channels. Or, to create a new digital channel. Deliver tailored financial products and services through any point of interaction of the customer's choice, enabling bank's to incrementally modernize or, leverage the Cyberbank Core platform.

CYBERBANK KONECTA

A customer experience platform—built on an AI-powered engine—enables FIs to deploy intelligent digital assistants (IDAs) to support their customer base. These IDAs are powered by an empathy engine that supports a positive and delightful customer experience, provides standardized 24/7 self-service options, along with text, call and video supported handoffs to bankers/agents. The empathy engine uses a combination of machine learning, natural language processing and AI.

PAYMENTS AND CARD ISSUING

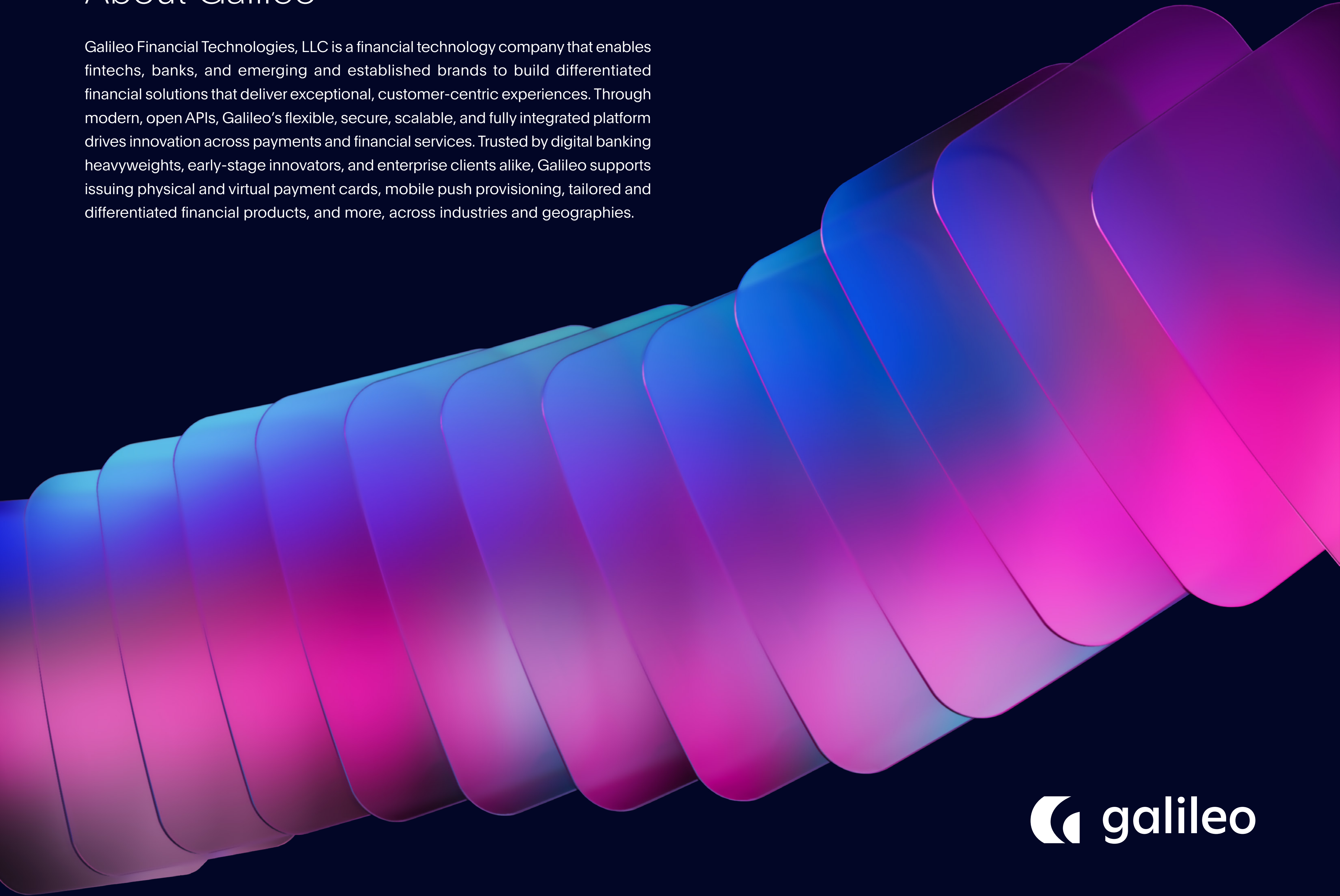
Galileo's flexible, secure modern payments processing platform allows FIs to effortlessly incorporate debit and credit programs, digital payments, virtual cards, accounts receivable and payable solutions, and more through easy-to-use APIs, documentation, sandbox environments, and third-party connectivity.

TECHNICAL AND OPERATIONAL EXPERTISE AND MANAGEMENT

Technology and expertise come together with the most robust team of BaaS experts in the market. FIs gain new ways to operate faster, smarter, and more cost-effectively with intelligent automation and have access to a liquid workforce that works anywhere, anytime on projects with varying durations. FIs can count on Galileo for any of the financial and technical operations services they need, including security, compliance, risk management, customer service, and more.

About Galileo

Galileo Financial Technologies, LLC is a financial technology company that enables fintechs, banks, and emerging and established brands to build differentiated financial solutions that deliver exceptional, customer-centric experiences. Through modern, open APIs, Galileo's flexible, secure, scalable, and fully integrated platform drives innovation across payments and financial services. Trusted by digital banking heavyweights, early-stage innovators, and enterprise clients alike, Galileo supports issuing physical and virtual payment cards, mobile push provisioning, tailored and differentiated financial products, and more, across industries and geographies.



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