Embedded Banking: Debunking the Myths

Five Misconceptions Preventing Community Financial Institutions from Leveraging This Game-Changing Technology

Embedded Banking in Action

A business platform offering guided services to help small business founders launch, run, and grow a successful business recognized a need for its small business customers to have a business account early in their growth lifecycle. The company is not a bank and does not want to be a bank, but it hoped to address its customers' needs by offering a key financial service through embedded banking technology.

The business platform benefits by reaching new entrepreneurs as a result of the partnership with the financial institution.

The financial institution benefits by attaining new high-value commercial deposits, gaining a greater ability to attract new customers at a lower cost of acquisition, and realizing increased engagement and retention of its existing customers.

Embedded banking has emerged as a promising way for banks and credit unions to extend their reach through collaboration with non-financial partners. But, as with many newer technologies when they first elicit buzz in the industry, myths about this opportunity abound, with many financial institutions misunderstanding both how the technology works and the benefits it can offer.

What is Embedded Banking?

By design, embedded banking allows banks and credit unions to serve their customers and members through a non-bank third-party partner, at the point of need. In the physical domain, it is like putting a branch inside a supermarket. In this scenario, both the financial institution and the supermarket offer convenience to consumers through the combination of grocery shopping and banking in a single location. Importantly, the institution gains access to consumers who may not otherwise be exposed to its brand.

The same concept can be applied in the digital world. By adding banking capabilities within a non-financial partner's software, consumers and businesses gain convenience by being able to perform banking functions within the partner's application.

Because embedded banking is not clearly understood by many, certain myths have emerged that may be holding institutions back from taking advantage of this technology. Following are five common myths that exist today—and reasons why community banks and credit unions should consider incorporating this emerging opportunity into their strategy.

Myth #1: Embedded Banking Is Merely a Fad

Embedded banking represents an entirely new channel, providing financial institutions with the opportunity to increase their relevance with existing consumers and businesses while fueling growth of new accounts. Though some have suggested it could be a passing trend, consumers and businesses are demonstrating an openness to accessing financial services in new and different ways.

Consider that there are 39 million challenger bank users in the U.S. today, and the number is growing. That's 39 million consumers and/or small businesses who have actively engaged with a non-traditional partner to help simplify their financial lives.

At the same time, the number of financial institutions is shrinking, with the U.S. seeing a 70% decline from 1982 to 2022. In other words, 7 of 10 banks from 1982 no longer exist today. As today's financial institutions seek to avoid a similar fate, embedded banking represents a way to fundamentally expand how they are reaching and servicing customers and members.

Rather than thinking of embedded banking as a here-today, gone-tomorrow trend, consider it an entirely new channel to increase relevance with existing account holders. More importantly, it represents an opportunity for growth through exposure to communities not bound by geography, based on interest and the need for financial services.

Myth #2: Embedded Banking Will Power My Competitors

Some fear that embedded banking will power competitors to disintermediate their account holders. Those who take this position may be confusing it with Banking as a Service (BaaS)—but the two concepts are quite different.

With BaaS, challengers like Chime and Cash App directly provide financial services to users. Banking represents the core of their business, and they partner with chartered institutions to garner access to bank balance sheets for deposit insurance and The Clearing House for money movement.

Conversely, in the embedded banking model, financial institutions partner with an organization whose primary function is not banking, extending financial services to these non-banking applications or programs. Like putting a physical branch in a supermarket, embedded banking delivers financial services to enhance the partner's non-financial capabilities.

The takeaway? Rather than creating conflicts of interest or powering competitors, embedded banking functions as a bridge between the non-financial partner's app or website and the banking capabilities provided by the financial institution. The result is an opportunity to reach consumers and businesses outside of the institution's typical geographic area.

Projected 10X Increase in Embedded Banking Market Value

Embedded Finance Forecast Report from Lightyear Capital

Myth 3: Embedded Banking Is Only for Big Banks

Embedded banking has gained significant traction in the industry, and it's true that large, national financial institutions are getting into the game. However, of all the banks live with embedded banking solutions today, 70% have less than $10 billion in assets.

With a market projected to reach $230 billion by 2025, the opportunity is significant for financial institutions of all sizes. And because only a small portion of the market currently uses embedded banking, forward-looking community banks who embrace the technology look to gain the most from early action.

Understanding and embracing this new business model requires a cultural shift to embrace the non-financial partner's brand as a customer. This breaks from traditional business-to-consumer digital banking models where the end user is generally the customer.

Myth 4: The Technology Requires a Legal and Compliance Army to Operate

Financial institutions must adhere to legal and compliance issues around embedded banking. However, the market has demonstrated that incorporating policies around the technology does not result in an undue burden.

Legal and compliance teams should certainly be an integral part of strategy development, completing much of the compliance work up front as the financial institution maintains ownership of Bank Secrecy Act (BSA) policies to cover account underwriting, anti-money-laundering (AML) monitoring, and ongoing watchlist screening. The financial institution also owns the policy regarding identity verification (IDV/IDA/KYC) and sets the rules and audit adherence to these policies. Finally, the institution owns the underwriting standards for both accounts and loans.

Ultimately, regulators will confirm policies are in place and being followed by the financial institution and its partners. In short, responsibility for risk and compliance management requires collaboration between all involved parties.

Myth 5: Embedded Banking Is Too Difficult to Execute

Integrating financial technology with a partner's software may sound complex, but the right fintech advisor can provide access to a proven playbook that facilitates an embedded banking strategy. To get started, consider the following:

1. **Evaluate growth strategies.** How does embedded banking fit into your organization's overall growth strategy? Does it make sense for your brand? Where might it fit in your strategic planning?
2. **Establish a technology enablement partner.** The right enabling partner – like Apiture—can arm you for success with insights gained from experience and artifacts like agreements you can tailor to leverage with your non-bank partners. In addition, an experienced technology provider can establish connectivity through easy-to-implement developer toolkits and components that enable partners to easily bring banking services into their applications.
3. **Determine what services to embed.** Consider starting by offering account servicing options where users can view their accounts and transactions, then progressing into money movement and account and credit origination over time.
4. **Identify embedded banking partners.** There are numerous possibilities for embedded banking partnerships, including practice management solutions, industry applications, and others. Select these partners carefully and ensure strategic alignment since their solutions will serve as an extension of your brand. Should you require assistance in identifying an appropriate partner, an experienced embedded banking technology enabler like Apiture can help.

Moving Beyond the Myths

Embedded banking offers community banks and credit unions an exciting way to serve existing customers and members with greater convenience and to reach entirely new users through partnerships.

How can smaller institutions take advantage of this opportunity? The key is working with an experienced embedded banking technology enabler that can facilitate the necessary integrations, bundling and integrating your institution's financial services into a module available within the non-financial partner's application.

With the potential to create a meaningful difference in your financial institution's balance sheet, the time to act on this opportunity is now. Not sure how to get started? Contact us to learn more.

About Apiture

Apiture delivers award-winning digital banking solutions to banks and credit unions throughout the United States. Our flexible, highly configurable solutions meet a wide range of financial institutions' needs, from leveling the playing field with larger banks to enabling unique, digital-only brands. Through our API-first strategy, our clients can maximize the capabilities of their platform while preserving a seamless user experience. Our exclusive focus on digital banking means we're dedicated to delivering innovative solutions that meet the unique needs of our clients while providing a level of support that's unmatched in the industry. Apiture is headquartered in Wilmington, North Carolina, with offices in Austin, Texas.

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