

Building Smarter Fintech Partnerships for Innovation and Risk Control

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Executive Summary

Financial institutions (FIs) face increasing pressure to digitize while managing rising compliance costs and complex vendor relationships. The Conference of State Bank Supervisors (CSBS) reports that compliance costs now consume up to 22% of net income for many institutions. Success requires finding the right balance between innovation and risk management.

Key Takeaways:

1. Partnership risk extends beyond direct relationships – a comprehensive risk management approach is essential.
 2. Innovation and compliance aren't opposing forces – they are complementary requirements for modern banking.
 3. Successful partnerships require structured evaluation frameworks, continuous monitoring, and clear contingency plans.
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A Personal Note on Partnerships

Throughout my three decades in financial technology, I've consistently advocated for strategic fintech partnerships—long before it became an industry trend. These relationships represent opportunities for mutual growth, not competitive threats. The key isn't whether to embrace fintech partnerships—it's how to manage them wisely. Today's regulatory pressures, technological advancements, and rising customer expectations make this approach more critical than ever.

The Six Degrees of Financial Risk

Imagine this: A \$500 million financial institution suddenly lost access to its entire digital banking platform. The cause? Not a cyberattack or internal failure—but a vulnerability in a fourth-party vendor's system, three steps removed from their fintech partner. As a former regulator once told me: *"They didn't even know this vendor existed."* And I'm sure each of you can point to additional examples from your own experience.

This isn't a hypothetical scenario—it's a stark reminder of how interconnected our financial ecosystem has become. Every fintech partner comes with multiple layers of risk—each connection adding another potential point of failure. The stakes are high:

- 73% of security breaches originate from third-party ecosystems (Ponemon Institute, 2024).
 - The TD Bank AML case resulted in a \$3 billion penalty—showing that risk mismanagement, whether internal or through partnerships, has severe consequences.
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How Fintech Partnerships Drive Growth

When structured properly, fintech partnerships deliver substantial benefits:

1. Accelerating Innovation and Market Expansion

- Fintechs help FIs develop, test, and deploy cutting-edge solutions faster.
- PwC reports that FIs expect an average 20% ROI from fintech innovation projects.
- Successful partnership stories like JPMorgan Chase & OnDeck demonstrate new digital lending models.

2. Reducing Operational Costs

- Financial firms can save up to 30% in operational costs through automation, shared infrastructure, and optimized workflows (McKinsey).
- RegTech solutions have helped some financial institutions reduce compliance costs by up to 50% while improving detection.
- Streamlined processes through automated workflows.

3. Enhancing Customer Experience

- Seamless digital experiences not only boost customer satisfaction but also improve service delivery, driving increased retention and loyalty.
 - Forrester reports that institutions with strong digital platforms are 2.5x more likely to see high customer engagement and advocacy.
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The Risks That Can't Be Ignored

Fintech partnerships provide tremendous opportunities for growth and efficiency, but financial institutions must carefully address key risk areas to ensure success.

Key Risk Areas:

1) Regulatory and Compliance Complexity

- a) Institutions remain liable for compliance, even when outsourcing
- b) Regulatory fines for non-compliance reached \$17.4 billion in 2023 (Fenergo Global Financial Institution Fines Report, 2024)

2) Cybersecurity and Data Protection Failures

- a) 73% of breaches originate from third-party ecosystems (Ponemon Institute)
- b) The average cost of a financial sector data breach is \$6.1 million (IBM).

3) Operational Integration Challenges

- a) 40% of fintech partnerships fail due to misaligned strategy and operations (EY-Parthenon).
- b) Institutions need structured governance models to ensure seamless fintech integration

4) The Myth of Avoiding Third-Party Risk

- a) The answer isn't avoiding fintechs—it's about choosing the right ones and ensuring ongoing oversight.
 - b) Effective third-party risk management must include:
 - i) Continuous due diligence and monitoring
 - ii) Clear compliance frameworks
 - iii) Automated transaction transparency.
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Building a Resilient Partnership: Critical Due Diligence Questions

1) Operational Resilience and Integration

- a) How do you maintain control of critical records?
- b) What's your scaling strategy and capacity planning process?
- c) How do you ensure seamless integration with existing systems?
- d) How do you validate system interoperability during updates?

2) Compliance and Risk Management

- a) How have you automated compliance monitoring and reporting?
- b) What's your approach to Know Your Client's Customers (KYCC)?
- c) How do you detect and prevent fraud across the transaction lifecycle?
- d) How frequently do you assess and update compliance controls?

3) Security and Partnership Oversight

- a) What incident response and escalation procedures exist?
- b) How do you manage vendor access controls?
- c) What's your business continuity strategy?
- d) How do you ensure transparency in operations and reporting?

Practical Evaluation Framework

To move beyond subjective assessment, successful institutions evaluate potential fintech partners using a weighted scoring system across critical dimensions such as:

Category	Weight	Score	Weighted Score
Regulatory compliance	30%	-	-
Security Controls	25%	-	-
Operational Capabilities	20%	-	-
Financial Stability	20%	-	-
Cultural Fit	5%	-	-
Total	100%		

These percentages offer a starting point for evaluation. Adjust the weighting based on your institution's risk appetite, regulatory landscape, strategic priorities, and the specific characteristics of the fintech partner.

Financial Institutions That Will Lead

The future of banking isn't about choosing between innovation and regulatory excellence—it's about embracing both intelligently. My experience shows that successful institutions build partnerships with robust risk management at the core while maintaining transparency and security across their entire ecosystem.

The most successful implementations share key characteristics:

- Comprehensive risk management embedded in every process
- Seamless information exchange across all parties
- Full visibility into transaction flows
- Integration that adapts to existing systems rather than forcing full overhaul
- Strong compliance controls built into every process
- End-to-end audit capabilities
- Enterprise-level security and encryption standards.

At [Avalo Labs](#), I've seen how these principles come together in practice. The platform enables financial institutions to maintain visibility and control while working with fintech partners, integrating smoothly with existing infrastructure to ensure compliance and manage risk effectively without disrupting operations.

The path forward is clear: financial institutions that build smart, secure partnerships—supported by transparent, interoperable systems and strong risk management frameworks—will define the future of banking. The question isn't whether to innovate through partnerships, but how to do it while maintaining control of your destiny.

Mark Forbis brings over three decades of financial technology expertise to his role as a board member at Avalo Holdings. As the former CTO of Jack Henry & Associates, he has helped hundreds of financial institutions navigate the intersection of innovation and risk management.