Where New-Breed Fintechs Find Their Risk Managers

Many come from incumbent firms, shaking free of legacy constraints to confront new operational and cultural challenges

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By Katherine Heires

Fintech companies are defined as technology-driven disrupters. They have distinguished themselves by shaking up the old order, putting pressure on traditional providers of banking, payments and other financial services to be more innovative and efficient.

But the upstarts are not exempt from the regulatory rules that others must play by, nor are they immune to the risks that incumbent institutions devote significant resources to managing.

In that sense, the old and new worlds ultimately converge. And experienced risk executives are crossing over into a very different, though rapidly evolving and maturing, cultural landscape.

Philippa Girling, for one, was appointed last April as chief risk officer of Varo Money, a mobile banking venture founded in 2015, after serving as CRO of Investors Bank and business risk officer of Capital One Commercial Bank.

"It's fun to be at a fintech start-up where we can do everything with the latest technology," Girling says of Varo, which is based in San Francisco and is in the process of obtaining a national bank charter from the Office of the Comptroller of the Currency. "We are not held back by legacy processes, systems or approaches, and at every step of the way of building out our risk management systems, we get to ask, 'Is there a better way to do this?'"

"We are not held back by legacy processes, systems or approaches," says Philippa Girling of Varo Money.

Jerry Weiss, chief credit officer of online banking and financial advisory service MoneyLion in New York, says he welcomes being freed from the constraints of legacy systems. After 29 years in credit risk management at Citigroup and JPMorgan Chase & Co., he finds the technology and data sets he now has access to "very exciting. We are building out our systems and learning as we go, with lots of experimentation along the way."

Burdens to Carry

For all the freshness and excitement, there are a host of challenges. These risk managers shoulder a broad set of responsibilities. There are fraud, cybersecurity and data privacy threats to keep at bay, new solutions that have to be vetted and tested, and an ever-changing regulatory environment to stay on top of.

"I think risk managers entering the fintech arena have to be ready for a lot of frustration, as they will have to function as the brake pads on a machine designed to move very quickly," says Ryan Gilbert, general partner, Propel Venture Partners, a fintech venture capital firm with an international portfolio that includes Charlie, Earnest and SimplyCredit.

"The scope of risks is far wider for fintechs, as you have everything from regulatory, operational, fraud, technology, market and business risks to contend with," says Bernard Donefer, adjunct associate professor of information systems at New York University's Stern School of Business, who teaches a course on fintech risk management. It is thus imperative that the top risk executive not be "too far down in the company hierarchy."

Girling's remit at Varo includes credit and operational risk (she has written textbooks about the latter), information security, compliance, Bank Secrecy Act and Anti-Money-Laundering regulations and fraud prevention, while preparing for the firm's gaining full bank status.

"At a fintech, there are no shortcuts when it comes to risk management," says Girling. Although fintechs may have a reputation for being "risk management lite," she asserts, "If you are going to be a bank, as we aim to be, you have to have a strong risk management framework."

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A key for Girling is "hiring people for the risk team who have a growth mindset, understand the regulatory frameworks, and can safely innovate – all critical for success at a fintech."

The Regulatory Presence

That path to a bank charter has required frequent interactions with regulators. Many of the conversations, Girling says, center on "our risk management framework and making sure that we understand all of the regulatory requirements."

There is reason for the scrutiny.

According to a 2017 report by Deloitte, Fintechs and Regulatory Compliance: Understanding Risks and Rewards, actions against fintechs have involved consumer mistreatment, misrepresentation of lending practices and fees, privacy violations and Know Your Customer infractions. In one instance, the FBI found a link between a leading marketplace lending company and terrorist financing.

"The regulators are taking a closer look at fintechs," says Donefer of NYU.

He believes that the supervisory noose has tightened a bit since Facebook, which has suffered reputational damage due to its data protection practices, launched its Libra cryptocurrency initiative. Libra has, in turn, run into resistance from central banks and from commercial banks and payments companies that it had set out to partner with.

"What is clear is that a lot more needs to be done to enhance regulations around fintechs," Donefer says.

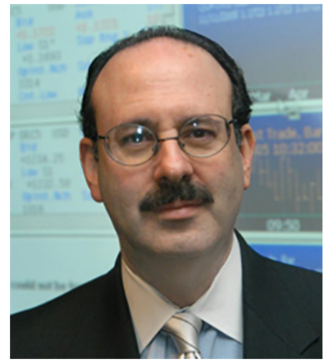
Progression of Priorities

When starting out, a fintech may have priorities other than bolstering compliance and risk management.

"There may be no focus on risk management initially," says Prakash Santhana, a managing director with Deloitte's Risk & Financial Advisory practice. "It is only after they have evolved into a more mature business that they do."

Typically, internal audit is first to “stand up,” followed by compliance or a second line of defense, Santhana says. If a company is offering checking or savings accounts or other bank-type products, often by partnering with an established bank, then “they tend to move faster in terms of addressing risk management issues, because of the immediate regulatory or licensing requirements.”

There is no national chartering mechanism for new-breed fintech banks in the U.S.; a special-purpose fintech charter proposed by the Comptroller of the Currency was disallowed following a court challenge by state regulators. Like any other firm, a fintech can be subject to a patchwork of state and federal banking and financial regulations. There are also compliance requirements set by such agencies as the Consumer Financial Protection Bureau, Federal Trade Commission, the U.S. Treasury's Financial Crimes Enforcement Network and Office of Foreign Assets Control, and European entities enforcing the General Data Protection Regulation (GDPR).



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“In fintech, I see compliance issues as weighing more heavily than other risk issues,” says Kenneth Abbott, a lecturer at the Zicklin School of Business, Baruch College, and a former Barclays CRO for the Americas. “Key questions for fintech risk managers to ask are: Who is your client? Do you know and understand what your algo does? Are you able to protect client data and apply appropriate levels of privacy?”

“We are at the early stages of risk management practices at fintech firms,” says Renier Lemmens, venture partner at DN Capital and visiting professor of fintech and innovation at the London Institute of Banking and Finance. “At present, it's all about old-school risk experience going hand-in-hand with new-school technology, and while risk managers at fintechs don't need to be experts in AI, machine learning or supervised and unsupervised learning, they do need some fluency in these areas so that they can discuss the tradeoffs.”

Attracting Expertise

Appointments of CROs at fintech companies are on the rise.

Berlin-based challenger bank N26 in April announced the appointment of Richard Groeneveldas CRO and chief financial officer. He was previously chief operating officer of DVB Bank.

In July, Social Finance – known as SoFi – in San Francisco named Aaron Webster CRO. He had been CRO for Citi's U.S. retail bank and mortgage business and led global regulatory analytics.

In October, Monzo, a four-year-old mobile bank in London that entered the U.S. market in the summer, appointed Lisa Nowell as CRO. She had been ClearBank's chief risk and compliance officer and had senior audit roles at Barclays and Royal Bank of Scotland.

London "fintech-as-a-service" company Rapyd, founded in 2015, has divided its risk responsibilities between David Hanna, chief risk and compliance officer, with oversight of the APAC and EMEA regions; and Tony de la Mora, chief auditor, risk and compliance officer, managing risk in the Americas and audit for all regions.

Data Points

Risk management opportunities multiply as the market grows.

"Fintech organizations are no longer fringe disrupters and have grown into sophisticated competitors," observes Matt Hatch, partner, Ernst & Young and EY Americas fintech leader. As tracked by that firm's Global Fintech Adoption Index, 64% of digitally-active consumers across 27 markets were using fintech-related services as of June 2019. That nearly doubled over an 18-month period.

"It's all about old-school risk experience going hand-in-hand with new-school technology," says Renier Lemmens of DN Capital.

Juniper Research, in a June report, said the number of consumers using digital wallets will rise from 2.3 billion in 2019 to nearly 4 billion, or half the world's population, by 2024.

Meanwhile, venture capital continues to flow. Research firm CB Insights said more than 1,700 deals worth nearly $40 billion were completed globally in 2018. In 2019's third quarter, $1.3 billion was invested in challenger banks, setting a quarterly record.

Social Impact

The professional attraction isn't just in potentially staggering numbers.

"The mission at Varo is to ensure access to financial services and financial security to those who have not previously had such access. That idea really resonates with me," says CRO Girling.

MoneyLion similarly aims to reach the underbanked. "We are all about making it easier for more people to bank, build their credit history and help their portfolio grow," Weiss says.

The chance to build a risk function from scratch motivates the entrepreneurial-minded.

"I am excited to look at risk management from the perspective of a clean slate, as we build our risk management framework from the ground up," says Girling. This allows for a single, streamlined taxonomy for risk and control efforts, as opposed to 25 or more that she might be contending with at a traditional bank.

Varo is building a data lake that will serve as a clean data repository without the layers and layers of legacy databases that traditional institutions wrestle with. This will make it far easier, Girling says, to address such concerns as adherence to GDPR, the new California Consumer Privacy Act, and the efficacy of fraud detection models – all with the benefit of being able to "trust the data."

"In a Learning Role"

Anthony Jerkovic, head of data and risk at Novo Platform, a year-old start-up in New York marketing banking services to entrepreneurs, says, "For me, the advantage of working at a fintech is being in a really dynamic environment where there is a lot of fact finding I have to do for myself. I'm in a learning role where every day presents new challenges and questions that need to be answered."

He has company, being ably assisted by the Bank Secrecy Act officer and a dedicated team at Novo's partner bank, Middlesex Federal Savings in Massachusetts. "I am in contact with them frequently – sometimes on a daily basis – on operational as well as strategic issues and frequently on risk tolerance matters," Jerkovic says.

He adds, "I think one of the coolest things about being in a fintech environment is the fact that fintechs like to work and partner with other fintechs," as Novo does with Alloy, an aggregator of KYC/AML and fraud databases, and Middesk, a platform for conducting background checks on other businesses.

Jerkovic, who reports to Novo's chief technology officer, does not have a traditional risk management background, though he has an MS degree in applied analytics from Columbia University, as well as a Certification of Professional Achievement in Business from Columbia, which included study in financial risk management. He was previously a business analyst at Xavier Group, a boutique corporate advisory firm in Western Australia.

"Be Very Outspoken"

MoneyLion chief credit officer Weiss says that in dealing with, say, development of a new product for which historical and analytical data may be limited or lacking, "you have to be very quick and nimble in terms of your ability to test and learn and change."

In addition, it is necessary on the credit analysis side "to be very outspoken . . . about what we should and shouldn't do," as well as how models are used, whom the firm lends to, and how much it lends.

"Fintech organizations are no longer fringe disrupters," says Matt Hatch of EY.

Weiss, who reports to the head of finance but also works closely with the head of technology and the CEO, adds, "In my banking days, everyone spoke the same language and shared the same history, traditions and banking culture. At MoneyLion, my assumptions are questioned every day, and this means you have to be outspoken about what the data tells you and not be wedded to tradition, because there isn't a whole lot [of that] at a fintech.

"The work is all about blending the use of advanced tools and expanded data sets with traditional, tried-and-true risk management practices."

Gina Primeaux, a Financial Advisory practice principal at Deloitte who works with fintechs, says that risk managers' mindsets must be compatible with the fast-changing, rapid-product-developing nature of these enterprises.

That type of environment might be tough for risk managers who lead with "no" and aren't good at listening and adapting. For others, Primeaux says, "It's a tremendous opportunity to be part of a rising wave and on the cutting edge of a business that always aims to be better."

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