

Banking As A Service

PLAYBOOK

The Banking As A Service Playbook: Powering The Next Generation Of FinTech Innovation, a collaboration with Transcard, examines the trends, technologies and key players that are bringing novel banking services to market.

POWERING THE NEXT GENERATION OF FINTECH INNOVATION



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WHAT'S INSIDE



More than 40 percent of U.S. businesses reported **receiving** at least some of their 2019 invoices via a technology that many younger Americans have probably never used: the fax machine. The phenomenon illustrates a long-standing problem in the world of B2B payments. Even as one-touch and seamless have become the guiding principles for consumer payments, many businesses are bogged down by legacy payment processes that collectively cost them billions of dollars in waste.

Things have been changing dramatically in recent years, however. Businesses themselves are increasingly able to take matters into their own hands and implement

mission-specific digital payment and banking solutions. These include automated accounts receivable (AR) platforms that can make the process of billing, collecting and account reconciliation a seamless function of a firm's enterprise resource planning (ERP) system.

Implementing such end-to-end solutions once would have been a multiyear process for businesses, requiring them to establish multiple banking relationships and integrate their products across a number of ERP applications and business units, all while requiring considerable changes to their existing infrastructure and onerous security and compliance measures.

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Banking-as-a-service (BaaS) models are turning the process of delivering banking services on its head. BaaS uses application programming interfaces (APIs), cloud-based systems and advanced artificial intelligence (AI) and machine learning technologies to make it easier for businesses and FinTechs to develop capabilities for sending and receiving payments as well as managing banking data. BaaS models serve as an important framework for relationships between banks that want to maintain and add value to their corporate customers, FinTechs with solutions that address specific inefficiencies and corporations that want to use payments and financial services to improve the value they provide to their end users.

BaaS models also support the creation of innovative payments ecosystems as lines between the physical and digital worlds blur and the ability to create and launch digital-first solutions becomes key to both banks' and corporations' competitive advantage. The Banking As A Service Playbook: Powering The Next Generation Of FinTech Innovation series, a collaboration between PYMNTS and Transcard, will examine BaaS and the trends and technologies that are helping banks, FinTechs and corporations capitalize on the shift to digital banking and payments. The Playbook series also highlights new use cases that are emerging in some of the most important sectors of the economy.

AROUND THE BaaS WORLD

A familiar storyline in the technology sector is that established legacy institutions are being undermined — if not disrupted out of existence — by Silicon Valley. BaaS appears to be facilitating growing ties between market incumbents and FinTechs, however. The Commonwealth Bank of Australia (CBA) illustrates this trend, having [launched](#) a service that seeks to eliminate the delays and complications associated with government-supported stimulus and loan programs enacted in the pandemic's wake. CBA's BizExpress Online program allows small to mid-sized business (SMB)

customers to access pandemic-related loans through online and mobile portals “within minutes,” according to the bank.

Another example of BaaS synergies can be found in a recently announced [partnership](#) between Amazon and Goldman Sachs. The venerable Wall Street bank will underwrite a lending service aimed at supporting small to mid-sized sellers on the technology company's marketplace. The service will help sellers support inventory costs and operational expenses.

Bank executives themselves are coming to recognize the vital role they could serve in the emerging BaaS ecosystem. A recent [report](#) by IBM found that nearly 80 percent of FI executives believe platform-based banking services will help them stay competitive.

FEATURE STORY: TAPPING THE POTENTIAL OF BaaS IN THE NORDICS

The European Union has in many ways served as an early proving ground for BaaS initiatives, thanks to its embrace of open banking. The revised Payments Services Directive (PSD2) has facilitated cooperation between FinTechs and banks by enabling the latter to share account information through secure APIs. BaaS collaborations often come about when entrepreneur-

ial technology companies partner with established FIs that already possess regulatory licenses and processing capabilities. One Nordic technology company has reversed this trajectory and decided to get its own banking license. Denmark-based [Lunar](#) began by offering a slick card app but has since transformed to collaborate with partners and launch a range of banking services, including financial management and investment. In this month's Feature Story (p. 6), Lunar chief operating officer Morten Sønderskov explains why he believes financial and technology companies are only just beginning to tap into the potential of BaaS.

DEEP DIVE: CASHING IN ON THE BaaS MODEL'S TRILLION-DOLLAR MARKET POTENTIAL

The potential value of the BaaS market could reach close to \$4 trillion over the next decade, according to a recent report. This eye-popping estimate reflects the degree to which platform-based banking services can transform every corner of the economy from business financing to insurance to home lending. This month's Deep Dive (p. 18) examines the core elements of this emerging economic ecosystem and the key use cases that could transform BaaS market potential into reality.



EXECUTIVE INSIGHT

How have the dynamics of the financial services ecosystem changed as result of BaaS capabilities?

The way banking as a service has evolved today, the platform augments and complements the traditional core. There's no reason banking-as-a-service platforms can't complement and sit side by side with an existing core platform, because BaaS platforms that are specialized are not trying to take over all functions and features of traditional core applications. Sitting side by side is super important from an FI's perspective — they're looking for a partner that will complement and align with their offerings.

RTP and some of these faster payment methods have been introduced, and there's been adoption by some large banks, but to address the businesses' needs, [banks may] still default back to some form of batch process or, if there are APIs, they're not holistically providing functionality end to end to address the businesses' needs. That's where a financial institution can really bring a solid service to their customers by embracing a platform that addresses their customers' needs flexibly, that integrates into their core platform itself and [that] integrates into the various payment modalities they support and want to build off.

Greg Bloh
CEO



5 FIVE FAST FACTS

Banking As A Service PLAYBOOK

80%

Share of global FI executives that believe banks will profit **from embracing platform business models**

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18%

Share of FIs that are **fully utilizing cloud technology** to offer innovative banking products and services

25%

Share of U.S. businesses that say their business customers **primarily pay them with checks**

\$3.6T

Projected size of **“embedded finance”** market by 2030

\$1M

Upper credit limit
Amazon is now offering select SMBs

LUNAR[®]

ON HOW BaaS CAN UNLOCK ACCESS TO NEW FINANCIAL SERVICES



THE CONCEPT OF BANKING AS A SERVICE

would have been nearly inconceivable ten years ago. This is not just because of technical limitations, such as hardwired legacy payment processing systems, but also because banking is so heavily regulated. A company cannot simply call itself a bank. The barriers that have historically made banking relatively insulated from experimentation and innovation are steadily lowering — perhaps nowhere more dramatically than in Europe.

The European Union has led the charge toward open banking, creating a regulatory framework through PSD2 that requires banks to open up their APIs to support expanded financial services. The shift has given rise to numerous FinTechs and neo-banks, such as Revolut and N26. Creating a hospitable regulatory environment and actually bringing novel financial services to market are two very different things, though, and FI incumbents with banking licenses are not necessarily eager to [give up](#) their market shares.

Denmark-based [Lunar](#) knows this well. The company began as a startup that offered a card app that could be linked to third-party bank accounts, but it then took the unusual move of formally becoming a bank, reversing a common trajectory found in the BaaS space in which established banks branch into digital services by allying with FinTechs and other technology platforms. Lunar is the FinTech that became a bank.

“With our own banking license, we [are] now in full control of partnering up with the companies [that] we would like to partner with when it comes to the financial infrastructure,” Lunar chief operating officer Morten Sønderskov told PYMNTS in a recent interview. “The second dimension of this is also being able to be in full control of what kind of other partnerships we would like to engage in, what kind of other products we would like to be able to present.”

Obtaining a banking license was not a simple process for Lunar, which operates in Denmark, Sweden and Norway. Sønderskov said getting the license took almost two years, but doing so has opened new frontiers for the bank, enabling it to bring the same seamless, mobile-oriented financial services it offered consumers to a sector that could sorely use them: small business.

NEW BANKING USE CASES FOR THE CREATIVE ECONOMY

An essential premise of the BaaS model is that it allows entrepreneurial firms and individuals to find new use cases for banking services to address specific market pain points as they emerge. One such use case is the growing freelance economy: An increasing share of professionals are now working as contractors in fields ranging from engineering to graphic design. These workers may be skilled in their professions, but they could have little experience managing the administrative and financial aspects of a business.

Lunar's early forays into the B2B sector have focused on this segment. Sønderskov pointed to a freelance photographer and a small production company as examples.

"They need to have an account where they can receive and send money and they need to have some payment cards on top of that," he said.

Offering creative professionals those basic banking services and layering them with financial management tools gives the professionals the ability to better manage their expenses, he added. Businesses can also open accounts online and have them be active within ten days — a key benefit during the pandemic.

Lunar also makes digital financial management tools available to businesses

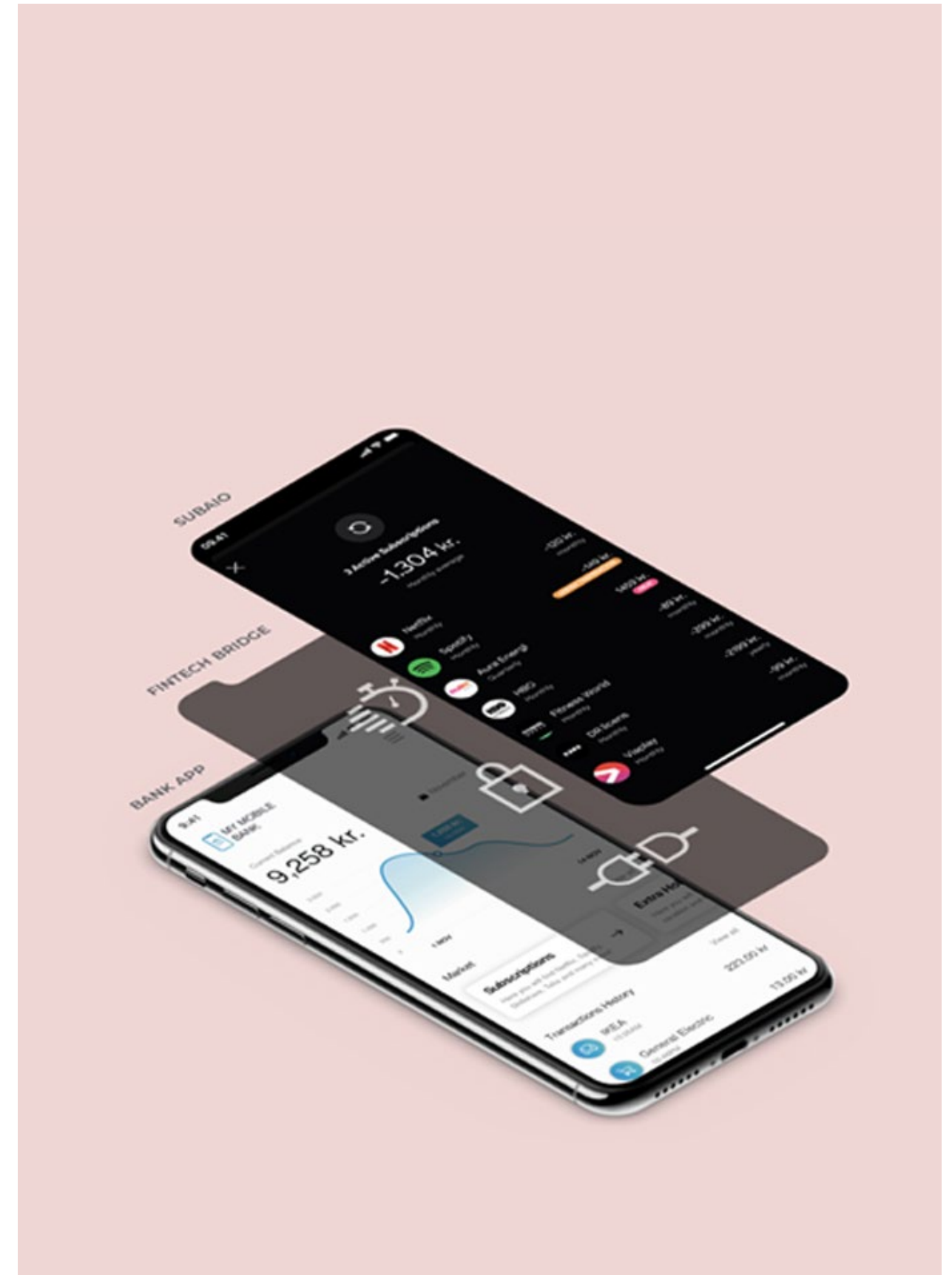
similar to those offered with consumer debit accounts. These tools can be integrated with third-party ERP and accounting systems, which also help small and microbusinesses keep track of expenses and expenditures for tax purposes. Offering such services is not necessarily about creating new revenue streams, Sønderskov explained.

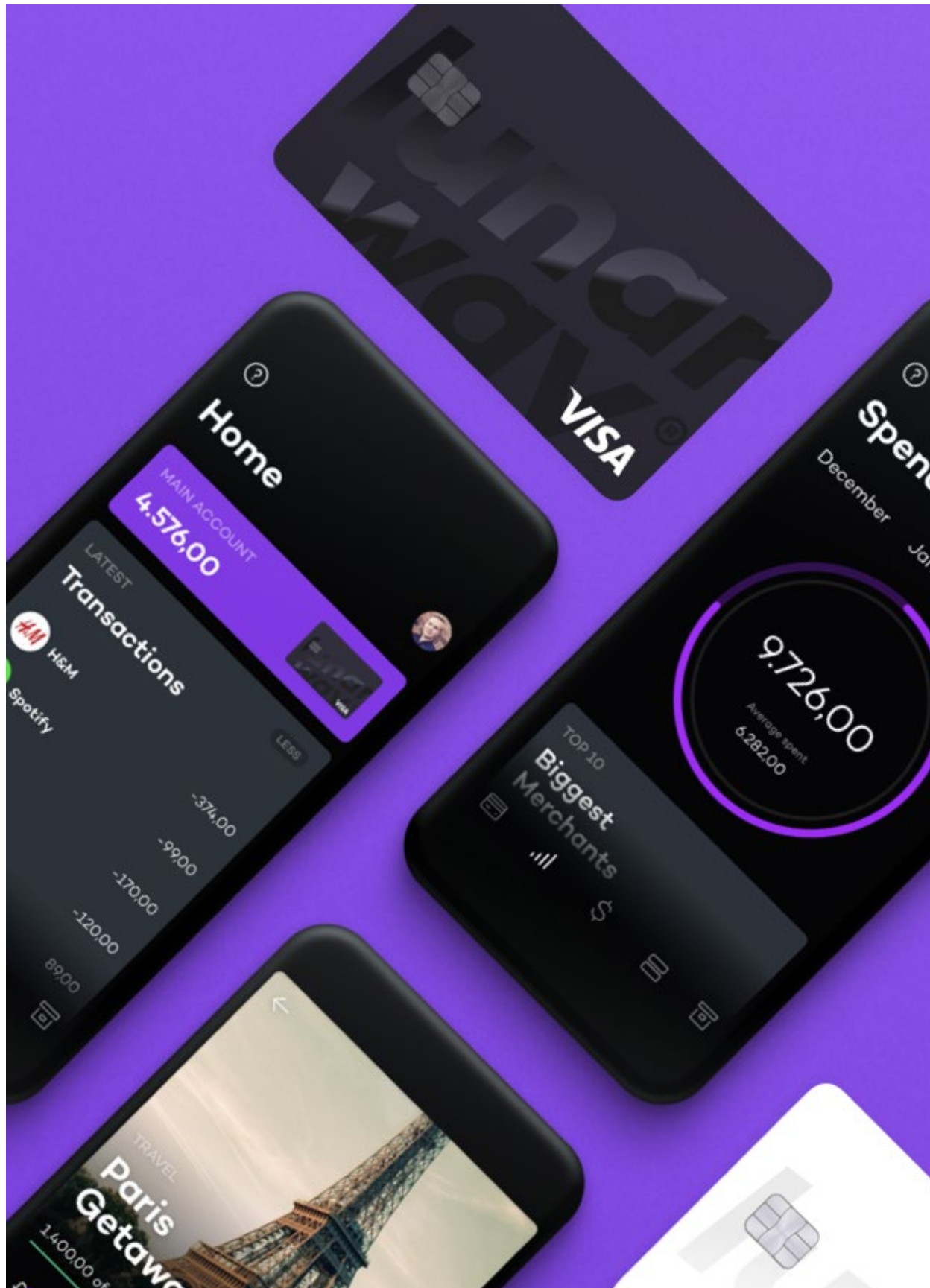
"It's a collaboration [with other financial service providers]," he said. "The combination may not in itself generate new revenue streams, but overall it just improves the value proposition of the product."

An approach that solves the financial pain points of smaller market niches can also be scaled up and applied to larger markets. Sønderskov cited insurance and mortgages as examples.

"We [realized] that there were so many pain [points] in the market that we could take away," Sønderskov said. "I have the feeling that we have just scratched the surface when it comes to whatever kind of value creation we are able to provide, together with other companies."

These kinds of innovations can happen when players in the financial services space start thinking outside the box of conventional banking.





NOVEL BANKING SERVICES FOR NOVEL TIMES

Changing attitudes around spending, saving and investing are key drivers of the BaaS market. Younger generations — millennials in particular — have shown a willingness to switch to financial institutions that offer genuine value and to walk away from those that do not, however trusted or venerable they may be.

This is how Lunar got its start: by offering a sleek, highly functional card app that could be integrated with any bank account.

“The journey of our customers is that they download the app, they try to use the product and they discover that the whole experience is just at a completely different level compared to what they’re used to,” Sønderskov said.

The key difference between Lunar and other neobanks is that the company is licensed to take deposits.

“It’s not just a virtual account but a real account that is connected to the national infrastructure,” Sønderskov said.

The COVID-19 pandemic and ensuing shutdowns have severely impacted every economy around the world, and spending and transaction volumes have declined. Lunar has experienced a paradoxical effect, however. New account sign-ups have been steadily increasing since the outbreak. Sønderskov believes part of the reason is that banking customers have had more time to think about their existing banking and financial relationships and make changes.

“We have seen an increase in the uptake of new customers month over month during this time, and I think that has actually also been to our benefit,” he said. “People have just had more time to reflect, ‘Is this time for me now to actually change, is it time for me to try something else?’”

Businesses and consumers around the world may be having similar ideas these days, especially as the pandemic presses on.

NEWS &TRENDS

THE BaaS MARKET'S **SHIFTING DYNAMICS**

BANKS UNIQUELY POSITIONED IN THE SHIFT TO PLATFORM/BaaS MODELS



The banking services offered by businesses and FinTechs are perceived in some corners as a threat to established FIs and the role they have historically played in safeguarding the deposits of consumers and businesses, but more banks are coming to see the rise of platform and BaaS models as opportunities rather than threats.

The share of global FI executives that regard platform-based banking as a competitive threat has declined since 2015, according to a recent report [published](#) by technology giant IBM. Nearly 80 percent of FI executives believe these innovations will help them differentiate themselves and compete, the study showed.

There is another reason why banks could be a crucial part of the BaaS equation: trust. The study found that 68 percent of consumers worldwide would trust banks and financial service companies with such information, whereas 46 percent said the same about insurers and 43 percent matched the sentiment for telecommunication companies. Less than 40 percent of consumers expressed confidence in sharing their personal information with healthcare providers and government agencies.

FINANCIAL SERVICE SECTOR LAGS IN ADOPTING CLOUD-BASED PLATFORMS

The unique position banks could enjoy in the shifting platform-based financial services landscape does not mean that they are adequately leveraging it, however. Many innovations in the BaaS space have been made possible through cloud-based platforms that allow users to move beyond the limitations of legacy payment processing systems and communicate with third-party partners through secure APIs. A recent [study](#) uncovered that a majority of banks and financial services organizations are only in the early stages of implementing cloud-based systems, however. Just 18 percent of financial service firms and banks have fully deployed such systems, while 70 percent of respondents' cloud projects are only in early testing stages. The findings suggest that FIs must find BaaS partners that can help them bridge this technology gap through open APIs and other tools.



TACKLING B2B PAIN POINTS

REPORT: FIFTY FIVE PERCENT OF FINANCE OFFICIALS SAY BILLING DISPUTES ARE AMONG THEIR GREATEST CHALLENGES

The BaaS model has gained traction because it allows banking and financial services to be deployed rapidly to address specific market pain points. Many company finance and treasurer officials would probably attest that B2B invoicing processes are among the most wasteful and burdensome aspects of their departments.

A recent survey [found](#) that 94 percent of company finance officials say they must manually input at least some invoice or billing information. This can lead to billing errors, disputes and late payments as well as wasted employees’ work hours. The report further found that 55 percent of B2B finance officials consider managing billing disputes one of their most challenging tasks. Nearly every respondent in the survey agreed that disputes contribute to late payments.

PANDEMIC HIGHLIGHTS STRAIN ON BUSINESSES DUE TO SLOW, INEFFICIENT PAYMENT PROCESSES

The pandemic and its economic fallout have exacerbated the toll inefficient billing and payment processes are taking on businesses. A recent study has [quantified](#) these impacts, finding that 43 percent of invoices’ total values are adversely affected by late payments. This represents a substantial increase from the 25 percent value reduction estimated last year. The latest report also noted that the value of invoices that are significantly overdue is more than twice as high as it was last year. The data underscores the potential value of BaaS solutions, such as digital AR and AP platforms and B2B financing services. Such innovations could not only make invoicing processes more efficient in the current economic environment but could confer distinct competitive advantages.

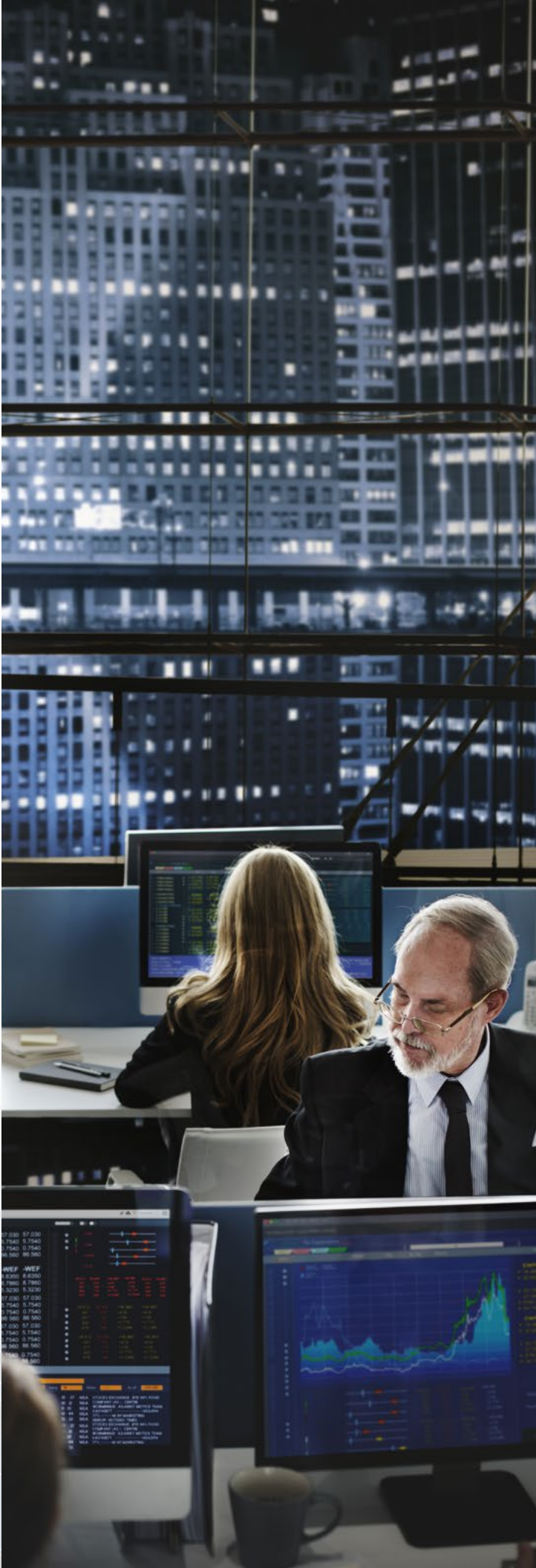
EXTENDING BANKING SERVICES’ REACH

PANDEMIC PROMPTS AUSTRALIAN BANK TO LAUNCH DIGITAL SMALL BUSINESS LENDING PLATFORM

Governments around the world have enacted stimulus and lending programs aimed at supporting firms during the pandemic, especially smaller businesses with limited resources. These programs have met a long-running challenge when quickly getting funds to businesses, however: [delays](#) and red tape.

The Commonwealth Bank of Australia has [launched](#) a service that seeks to bring these unique types of disbursements into the digital age. The bank’s BizExpress Online program enables existing SMB customers to access pandemic-related loans through online and mobile portals “within minutes,” according to the bank.

The program is part of a larger effort on the part of CBA to enhance digital services for small businesses. The bank plans to invest \$1 billion per year in digitization initiatives and is working to expand partnerships with traditional banks and FinTechs.



PANDEMIC SPOTLIGHTS NEED FOR DIGITAL BILLING AND REVENUE MANAGEMENT SOLUTIONS IN HEALTHCARE

The pandemic has placed unprecedented demand on the healthcare system while also creating revenue crises for many institutions because it has forced many of them to delay nonemergency procedures. Hospital emergency departments have [reported](#) a more than 50 percent decline in patient volumes, according to recent data, and pediatric volumes are down by approximately 65 percent. The difficulties associated with billing have been further complicated by the fact that more than two-thirds of U.S. consumers have lost job-provided health insurance coverage during the pandemic.

The situation has compounded a challenge with which the healthcare sector has long struggled: inefficient and complex billing practices. It has been [estimated](#) that wasteful billing practices cost U.S. healthcare providers and insurers nearly \$300 billion annually. This may help explain why most U.S. healthcare officials [plan](#) to maintain or increase investment in automation solutions, despite budgetary challenges. Digital AR platforms can not only help organizations reduce the time and expense of manual invoicing and collecting but also offer data visibility that can inform better strategic revenue decisions.



FIRMS BRING BaaS TO COMMUNITY BANKS AND CREDIT UNIONS

Smaller banks have long understood the need to meet consumers' growing demand for online and mobile banking services. The COVID-19 pandemic has forced these FIs to quickly accelerate their plans to serve consumers who are eschewing in-person services for digital ones. Many FinTechs and BaaS providers are now working directly with community banks and credit unions (CUs) to quickly bring their digital capabilities from the drawing board to the web.

One BaaS provider offers what it [bills](#) as the first cloud-supported and sandboxed banking solution geared specifically for community banks and CUs. The platform can be implemented within 90 days and supports wide-ranging features, including P2P and contactless payments. Another tech provider is rolling out cloud services aimed at community banks and CUs. The subscription-based service is [positioned](#) as an affordable alternative to on-premises systems.

NEW BaaS PARTNERSHIPS AND DEALS

BaaS FACILITATES SHIFT FROM CONSUMER TO CORPORATE VIRTUAL CARDS

A large gulf has historically existed between consumer and corporate credit card products. Moving from one product segment to the other required significant planning and investment on the part of issuers. The BaaS model is changing all that.

A case in point is Privacy.com's recent [move](#) into business-to-business (B2B) payments. The financial technology provider began by offering consumer virtual cards, secure one-time-use codes for card payments, and then discovered that many businesses adopted its platform to automate their own payment needs. The FinTech, buoyed by the success it has achieved with its BaaS-driven virtual card solution, is in the process of developing APIs that will integrate its virtual card solutions directly into a company's back-office systems, including accounts payable portals and ERP applications.

BANK HARNESSSES THE CLOUD

Banks are also migrating away from hardwired legacy processing systems and toward cloud-based banking platforms. Standard Chartered, an international bank active in 60 markets around the world, plans to become a fully cloud-based bank by 2025. The bank [hopes](#) to bring new digital ventures to fruition, including BaaS and virtual banking, by teaming up with a tech giant to leverage its cloud platform. The FI plans to provide cloud services while safeguarding customer security and ensuring compliance with any necessary rules and regulations. The bank will also employ the cloud platform's artificial intelligence (AI) and data analytics capabilities to enhance banking processes and personalize its client products.

GOLDMAN SACHS TO PARTNER WITH AMAZON ON SMB LENDING PROGRAM

There is a common misconception that the growth of BaaS is driven by startup FinTechs and smaller FIs rather than venerable legacy banks. Goldman Sachs, the United States' largest FI, is dispelling this notion by [partnering](#) with Amazon to provide underwriting and lending services for SMBs operating on the marketplace. The FI's proprietary digital underwriting decision platform will use data from the eCommerce giant's third-party sellers to offer SMBs inventory and operational financing support. The move illustrates how BaaS is blurring the lines between Big Tech and finance power players.

DEEP DIVE

THE TRILLION-DOLLAR POTENTIAL OF BANKING AS A SERVICE

The market potential of emerging industries is typically estimated in the range of billions of dollars — and sometimes the hundreds of billions. It is **estimated** that the value of the global market for smart home technology will reach \$135 billion by 2025. Banking as a service is different by orders of magnitude. One recent report projected that the global market for “embedded finance” could be **worth** \$3.6 trillion by 2030. Another **report** found that 12,000 financial startups were vying for a share of the BaaS market that is already worth \$1 trillion.

Looking at the gap between recent innovations in consumer payments versus the practices that prevail in the B2B space can help explain why BaaS’ market potential looms so large. Consumers can have almost any product they want delivered to

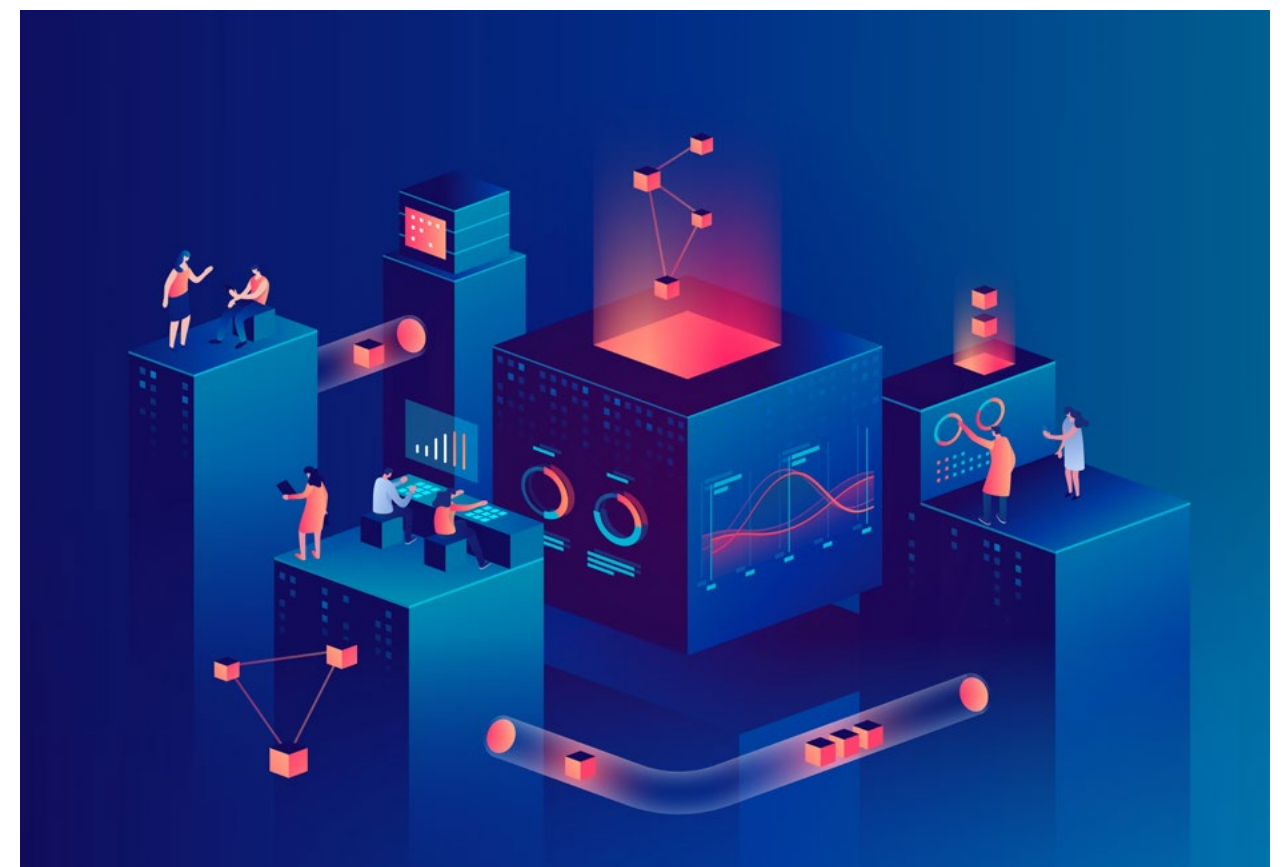
their door or pay a friend for a meal with a single tap on a smartphone, while a health-care clinic could spend months trying to get paid on a single invoice and a business waiting for an insurance payout could face similar delays. This is also true for a small business trying to collect from a client, severely impacting its cash flow.

Developing solutions to address these myriad pain points can be a complicated endeavor, however, from both regulatory and technical perspectives. Innovators and entrepreneurs in the FinTech sector need to be able to quickly bring to market solutions that mesh with dated banking and invoicing systems. Platforms are fortunately emerging that serve as intermediators between technology and finance, and these could be key to unleashing the BaaS model’s full trillion-dollar potential.

BANKING ON BaaS

The banking and technology sectors have had an uneasy relationship at times. Many FIs have struggled to keep pace with the transformations brought by the shift to digital payments and have been weighed down by antiquated core processing systems. BaaS is nonetheless creating synergies between banks and FinTechs by allowing the former to bring new products and services to market while avoiding the cumbersome and costly processes of obtaining their own regulatory licenses or building custom payments infrastructures.

Regulatory changes that make it possible for banks to share data with third parties through secure APIs have facilitated these shifts. The European Union has led the way with its updated Payment Services Directive (PSD2) regulatory framework and wider embrace of open banking. New laws have been a boon for some banks, and not just large ones with substantial in-house IT resources. The revenue generated through new open banking initiatives in the U.K. was **estimated** at \$700 million in 2018.



The United States has been slower to embrace open banking, yet its smaller banks have also been beneficiaries of the rising BaaS market, as they can charge higher interchange fees than large banks under existing regulations. U.S. banks offering BaaS generated 200 percent to 300 percent greater returns on assets than other banks, according to one report.

Banks provide a less tangible asset when it comes to BaaS, one that is key when offering consumers new financial services: institutional trust. A recent report [found](#) that consumers were considerably more likely to trust banks with their personal data than other institutions, with nearly 70 percent willing to do so.

BUSINESSES AND THE BaaS OPPORTUNITY

Uber is in many ways the poster child for a disruptive technology company, given the way it has upended the taxi industry and pursued other mobility initiatives, including autonomous vehicles. Uber has also made important if less conspicuous financial innovations, however, as the company offers its drivers vehicle financing, instant payouts and other financial services. Such offerings exemplify the BaaS model, allowing companies to quickly roll out and scale their own financial and banking services.

It is perhaps not surprising that technology platforms and marketplaces have responded to BaaS initiatives. Amazon has made a major push into financial services through merchant and consumer financing — the company [generated](#) more than \$1 billion through small business financing in 2019 alone. There has also been speculation that the company will one day launch its own formal bank.

BaaS innovation is not confined to Silicon Valley, however. Real estate companies are offering mortgage financing services, and third-party credit financing services are [helping](#) smaller merchants offer online financing, just two of many applications across the economy.

BaaS capabilities could be part and parcel of a larger integration of digital banking and payment capabilities, such as real-time payments. Flexibility is a defining characteristic of the BaaS model, and firms can take advantage of wide-ranging banking operations for both customer-facing or back-office purposes, [allowing](#) for organization-specific applications.

The COVID-19 pandemic has strained businesses' finances as well as banks' balance sheets. It has also unleashed a large-scale migration to digital banking. Providing superior, novel digital banking capabilities through BaaS may no longer be only the prerogative of innovative organizations but that of any firm that hopes to thrive in the new reality.

**U.S. BANKS
OFFERING BaaS
GENERATED
200 PERCENT
TO 300 PERCENT
GREATER RETURNS
ON ASSETS
THAN OTHER BANKS.**

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Transcard

Chattanooga-based Transcard is a SaaS funds disbursement and management platform that takes regulatory, time and cost burdens off payers while providing payees secure, self-service options for receiving their money. The company’s online platform greatly simplifies payment processes for organizations across a broad range of industries including financial services, corporate disbursements, insurance, hospitality, and payroll. Designed with both the institutional customer and the end payment recipient in mind, Transcard’s proprietary platform greatly simplifies the distribution of money by offering such features as configurable workflows, streamlined processes for the payer and robust options for the payee. Transcard clients can rapidly deploy full-featured, customized payment products with little up-front investment through its subscription-based model.

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