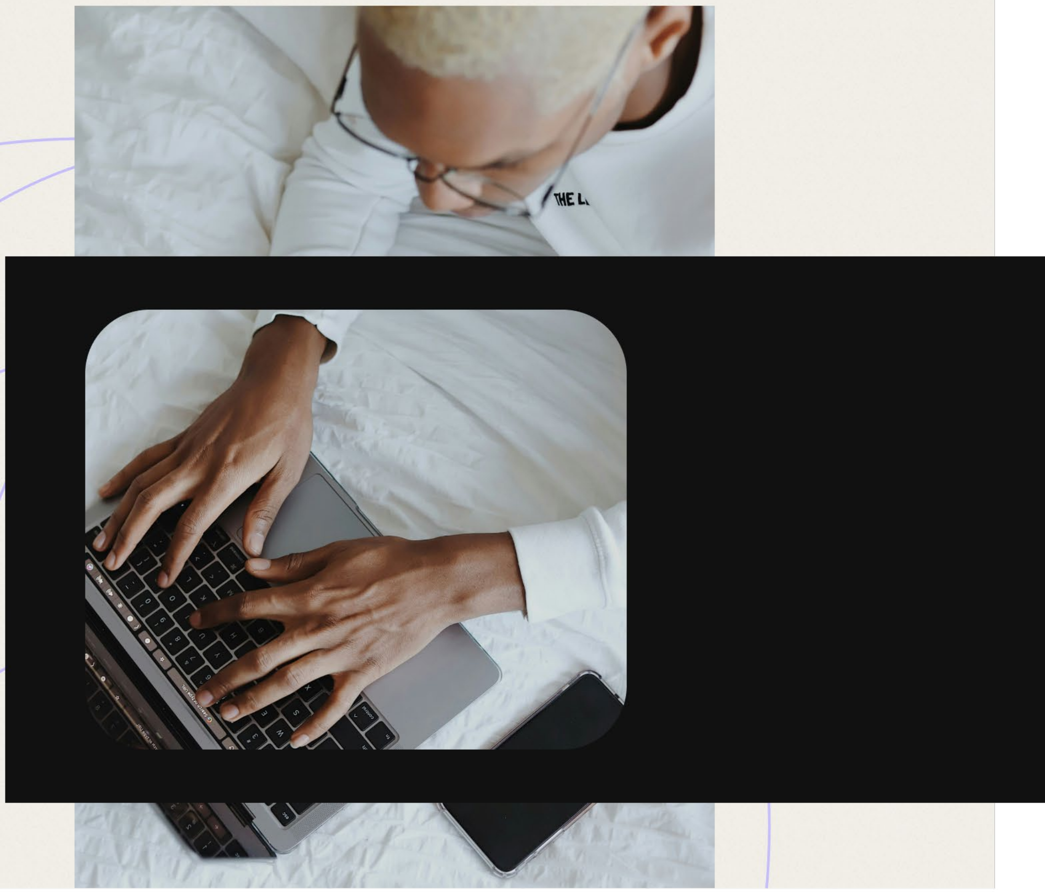
PLAID

plaid.com

The future of finance: 4 trends driving growth



Contents

A word from Plaid

Over the past few years, our financial lives have moved online with impressive speed, from digital-only banking and a greater use of ecommerce to online loan approval and even apartment applications. The effects of this shift are being felt across the industry.

Consider fraud. The current rise in account takeover and synthetic identity fraud, for example, is a direct result of an increase in online transactions coupled with easier and more affordable access to technologies like artificial intelligence—a key tool being weaponized by fraudsters.

Consumer payments have also evolved as a direct result of the shift to digital. As more businesses move online, more transactions are being carried out by debit and credit cards, despite their high processing fees. In search of cost-saving alternatives, many merchants are turning to pay by bank which, as an added benefit, is opening the door to a new segment of customers—those who might not have a credit card at all.

Indeed, the financial services industry is discovering the untapped potential of underserved populations. Take lenders who, amid lingering fears about economic growth and higher interest rates, are looking to broaden their pool of credit-worthy borrowers. Doing so requires moving beyond the exclusive use of traditional credit-rating solutions, which offers limited visibility into a consumer's increasingly complex financial profile.

These issues have been the driving force behind much of the innovation coming out of Plaid today. That's because, from the very beginning, we've made it our mission to democratize financial services through technology. And that means democratizing not only the tools that empower consumers to lead better financial lives, but also the tools that help businesses function securely, profitably, and compliantly.

Which brings us to the upcoming implementation of Dodd-Frank Section 1033 and what makes it truly so exciting: By directing how consumers' financial information must be shared, Section 1033 will help ensure proper data management and accord consumers full control of what is rightfully theirs. An essential first step to what, we believe, is the future of open finance.

—Jen Taylor, President, Plaid

TREND 01

Smarter fraud fighting

As fraud continues to rise and take on new forms, it remains a major concern for financial institutions and financial apps and services. Its prevention requires a collective approach.

When it comes to fraud, what is currently top of mind in the financial services sector?

A recent report by TransUnion[1] found that the growth of suspected digital fraud outpaced that of digital transactions by 133% from 2022 to 2023. It also found that account takeover fraud surpassed credit card fraud to become the most common type of digital fraud, with many credit unions and community banks reporting increased instances of it in the latter half of the year. This is having a particular effect on fintech companies, which saw an 808% increase in account takeover fraud year over year in the second quarter of 2023.[2]

13.5%

13.5% of all global digital account openings are suspected of fraudulent activity.

Source: Thomson Reuters

What is account takeover fraud and how is it different from third-party identity fraud?

Account takeover fraud refers to the use of stolen login credentials to seize control of a financial account. This can be carried out through different means, including credential stuffing, phishing attacks, and social engineering. On the other hand, third-party identity fraud—which includes synthetic identity fraud—traditionally involves using personally identifiable information such as names, social security numbers, phone numbers, and addresses to create false financial accounts or apply for a line of credit.

How is artificial intelligence (AI) playing a role in all this?

AI has led to a significant increase in the sophistication of fraud attacks, through things like deepfake technology and AI-powered password cracking. A study[3] of one such password-cracking tool found that 51% of passwords were found in less than a minute, 65% in less than an hour, 71% within a day, and 81% within a month.

1 TransUnion, 2024.
2 Plaid, 2024.
3 Thomson Reuters, 2024.

A recent survey of 1,200 global CEOs showed that, despite investment in AI strategies, companies face significant challenges in formulating and operationalizing their plans. Though more than two-thirds of respondents recognized the urgent need to act on AI, many felt hindered by the uncertainties surrounding it.

42%

Over 42% of fraud attempts now use AI—29% of which are successful.

Source: The Fintech Times

How are companies combating these threats?

While AI is increasingly powering various types of fraud attacks, it's also being harnessed by companies in the form of fraud protection. Many of the world's largest financial bodies are actively investigating ways to leverage the technology to their benefit. Visa, for example, recently partnered with Pay.UK to launch an AI-powered, real-time fraud detection service in the United Kingdom.

1.7%

Fintech companies lose 1.7% of their revenue to fraud every year.

Source: Plaid

When it comes to more established forms of fraud prevention, companies typically use multiple third-party services: The average ecommerce company, for example, uses five fraud-detection tools.[4] Unfortunately, most tools work in silos and are not designed to communicate with each other.

How can companies better prepare for fraud's ever-evolving threat?

A report[5] from the US Treasury illuminates a significant gap in AI-related fraud prevention, in which larger financial institutions have a notable edge over smaller ones thanks to more historical data and expertise to develop their own anti-fraud AI models. The report also finds a greater need for financial institutions to share data with each other to better train their anti-fraud AI and machine learning models—suggesting an industry-wide network approach should be adopted.

Learn more *about the most common types of fraud and how Plaid is building* an anti-fraud network *for fintechs and financial institutions.*

4 Cybersource, 2024.

5 US Department of the Treasury, 2024.

TREND 02

The rise of pay by bank

Pay by bank is growing even faster than many expected. In fact, adopting bank-linked payments is now the second highest priority for merchants.[6]

What is pay by bank?

Pay by bank (PBB) refers to a direct payment from a customer's bank account to a business's bank account without the use of a payment card. A typical PBB transaction usually happens in a matter of seconds, as follows:

1. A customer chooses PBB as their preferred payment option at checkout.
2. The customer then securely makes a connection to their bank account through an open banking payments network and authorizes the payment.
3. The payment is processed and the merchant receives the funds.

$172B

In 2023, US merchants spent more than $172 billion in swipe fees.
Source: Merchants Payments Coalition

What makes PBB more attractive than other forms of electronic payment?

The key difference between PBB payments and card payments is the payment rail employed. With PBB, payments travel on bank rails like ACH in the US, Faster Payments in the UK, or SEPA Instant in Europe. With credit and debit cards, payments travel on network rails owned by Visa or Mastercard. The latter are substantially more expensive. In fact, internal research by Plaid shows that the use of PBB over cards currently saves businesses anywhere from 20% to 70%.

In addition, most cards expire every four to five years (if not canceled due to theft or loss). The average lifespan of a bank account, meanwhile, is estimated to be 17 years, meaning much lower churn on stored payment information.[7]

6 Merchant Risk Council Survey, 2024.
7 Plaid, 2024.

70%

Nearly 70% of consumers are open to pay by bank, even when credit and debit cards are an option.
Source: Plaid

40%

Pay by bank can reduce merchants' overall payment costs by over 40% compared to cards.
Source: Plaid Research

This has always been the case. Why is PBB growing in popularity now?
While PBB solutions have existed for years with varying levels of success—notably in Europe—their recent expansion in the US and beyond has been driven by multiple factors:

- Younger generations are shifting away from credit usage entirely (69% of Generation Z report using debit cards frequently, versus 39% for credit cards[8]), creating a wider opening for PBB by offering a digitally native alternative.

- Access to account-based payments is rapidly growing in the US. While the ACH network is already ubiquitous, instant payment methods RTP and FedNow continue to expand: RTP now reaches 65% of all demand deposit accounts and FedNow counts over 700 participating financial institutions participating.[9]

- Consumer willingness to adopt PBB has increased in parallel with an evolving landscape, which has included a global shift from in-store to online purchases, the increased use of electronic payments, and the accelerated adoption of digital financial apps and services due to the COVID-19 pandemic.

- Unlike European PBB solutions, the size and fragmented nature of the US market has made the creation of similar centralized solutions both challenging and unlikely. With the expansion of open banking, however, APIs are making it possible to facilitate access to a wide audience without the need for a centralized solution—ensuring PBB is easier and cheaper for both customers and merchants.

What hurdles remain to more widespread adoption of PBB?
Plaid's internal research found fear of fraud—including, most notably, account takeover fraud—to be the paramount blocker for consumer adoption of PBB. If consumers perceive PBB as presenting a security risk, their willingness to try and use the service will likely fade, hindering adoption.

8 EY, 2024.
9 Plaid, 2024.

On the merchant side, differences in business processes related to PBB remain a challenge. For instance, accepting instant bank transfers requires merchants to make numerous upgrades, such as real-time reconciliation, and put in place additional security measures.

Finally, PBB currently lacks the type of built-in mechanism for dispute resolution that makes cards particularly consumer friendly.

What can businesses do to help drive PBB adoption further?
Merchants' approach to facilitating PBB's expansion should be two-fold. On the back end, they should choose a payment processor that supports them not only in accepting instant payments but also in managing the necessary changes to their back-office processes. On the front end, merchants can also begin to incentivize consumers to use PBB by passing along some of their cost savings and/or by optimizing the user experience. Plaid's internal research revealed that a 1% incentive at checkout for high-value ecommerce purchases increased PBB adoption from 20% to 67%. Likewise, an improved user interface design lifted PBB selection during bill pay check-out from 39% to 72%.

Learn more *about pay by bank and how* Adyen *is helping revolutionize the payment landscape in North America.*

TREND 03

Underwriting's new era

Driven by the rise of consumer-permissioned data, cash flow underwriting is becoming more and more prominent, helping underserved borrowers access credit and lenders grow their business.

What is cash flow underwriting?

Cash flow underwriting uses a borrower's bank account data to gain real-time information about their income, expenses, and account balances. It can be included alongside credit scores to add a more holistic view of the borrower's finances and ability to repay a loan. It can also be used as an alternative to credit scores for those who are credit invisible, such as recent graduates or immigrants. It's estimated that an additional 19 million US adults could be evaluated for credit by using data other than credit scores.[10]

80M

Roughly 80 million US adults have faced some form of credit insecurity in the past 12 months.

Source: PYMNTS

How does cash flow underwriting help lenders grow their business?

Consumers, by and large, are becoming both comfortable with—and accustomed to—sharing their financial data. This means lenders are able to get a more complete and precise view of a borrower's financial health than ever before, covering everything from multiple income streams to potential loan stacking. A continuous account connection also means lenders can maintain a real-time view over a borrower's likelihood to repay *after* the loan is originated. All of this allows lenders to better manage complexity and risk—and thus grow their business with confidence.

83%

83% of lenders are open to using new types of data in credit decisioning.

Source: Plaid

Has cash flow underwriting been adopted universally?

As with most things in the financial sector, change takes time. Lenders have long understood that credit scores often provide an inaccurate picture of a borrower's ability to repay a loan and the vast majority—83% to be precise[11]—are open to including financial transaction data in their underwriting models. Until recently, however, such transactions data was difficult to access and new models—necessary to extract clear insights from that data—were expensive to build.

10 Plaid, 2024.

11 Plaid, 2023.

72%

72% of consumers say they are comfortable sharing cash flow data with lenders.
Source: Plaid

Other factors have also impeded cash flow underwriting's universal adoption: First, lenders must ensure both coverage and conversion of their consumer-permissioned application flow, as drop-offs hurt their bottom line; second, lenders must feel confident in the quality and compliance of the data they're analyzing; lastly, raw cash flow data—even when digitized—is complex and hard to use unless cleaned-up and categorized.

Do solutions to these hurdles exist?

The move toward open banking is making it easier than ever to address lenders' needs and concerns. Products like Plaid Check's Consumer Report[12], for example, use cash flow underwriting to build ready-to-use, real-time credit risk reports based on cash flow data and income verification technologies.

Learn more *about alternative credit data and find out how cash flow underwriting is going* mainstream*.*

12 Plaid, 2024.

TREND 04

Preparing for 1033

The long-awaited 1033 rule—regulating open banking in the US—is expected to be finalized this fall, bringing with it new compliance obligations and empowering consumers with greater financial control.

What is the 1033 rule?

Section 1033 is the United States's open banking law, passed as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2008. At its heart, 1033 is about giving consumers power, by stipulating that they—or the parties they authorize—have a right to access and securely share their financial data.

Currently, the Consumer Financial Protection Bureau (CFPB) is writing the rule that will put Section 1033 into action. In other words, the law states that consumers have the right to access and share their financial data, while the rule will indicate how data providers and authorized third parties should uphold the law.

8 in 10

8 in 10 American consumers rely on fintech, and half use fintech daily.
Source: Fintech Effect 2022

How will the rule affect fintechs?

The key takeaway from the rule's proposed version, made public in October 2023, is that authorized third parties (fintechs and other companies authorized by a consumer to receive financial information from a data provider) will have to take certain steps to be able to securely access the data that powers the financial services they provide. Broadly speaking, these steps are expected to cover:

- **Authorization:** The rule will likely stipulate that third parties must obtain consumers' authorization to access their data, that consumers must be able to revoke that authorization at any time, and that access must be reauthorized at least every 12 months.

- **Retention:** The rule will likely require authorized third parties to keep records that show they've followed the authorization requirements.

- **Onboarding:** The rule will likely require authorized third parties to provide certain information to the data provider to help verify that they're a legitimate entity and show evidence of adequate security practices.

3-4

Americans use an average of 3-4 apps to manage their finances.

90%

Fintech has helped 90% of consumers in some way.

Source: Fintech Effect 2023

How will the rule affect financial institutions?

Based on the proposed version of the rule, data providers (financial institutions and other companies consumers do business with, which maintain certain financial information about those consumers) will likely be required to:

- Establish and maintain a developer interface (API) for third parties to access consumer-authorized data. These interfaces will likely have to meet certain standards and make data available in a generalized format, without unreasonable access caps and pursuant to certain security specifications.

- Retain compliance records when consumers permission data from them to an authorized third party. At the same time, they will likely have the right to assess whether a third party is a legal entity and whether it maintains adequate data security.

Increasingly, companies may be operating as both data provider and recipient, which will impact the compliance calculus. For instance, a bank may make consumer permissioned data available, while also leveraging open banking data to build their own services and tools.

When is the rule taking effect?

The rule is expected to be finalized in the fall of 2024 and some of its requirements may go into effect in as quickly as 60 days.

What should my business be doing to prepare?

Given the brisk timeline expected for the implementation of some of the rule's requirements, preparing your business's compliance in advance is paramount. Fortunately, you need not do it alone. Companies can work with data access platform partners, such as Plaid, to help meet many of the expected new requirements, including authorization and onboarding.

Learn more *about the 1033 rule and check out our* Open Banking Readiness Guide *to ensure you're prepared for the upcoming changes.*

Plaid is here to help.

To help you navigate this ever-changing landscape, Plaid provides a full suite of solutions that work together across each aspect of your business.

Fraud

Plaid Beacon is our anti-fraud network enabling real-time, secure information sharing across the ecosystem. It safeguards against stolen identity, synthetic, or account takeover fraud, helping break the chain reaction.

Payments

Plaid Pay by Bank offers a safe and secure alternative to credit cards and saves businesses an average of 40% on processing fees—the internet's lowest cost way to pay.

Credit

Our FCRA-compliant Consumer Report is addressing lenders' needs by offering real-time, actionable cash flow data along with credit risk insights through Plaid Check, our consumer reporting agency (CRA).

Regulation

Plaid has readied a comprehensive view of 1033's upcoming obligations. We've also released a suite of open finance solutions to help you prepare.

Plaid powers the digital finance solutions that enable millions of people to live healthier financial lives. Trusted by thousands of the world's leading companies and connected to thousands of financial institutions across the U.S., Canada, U.K., and Europe, Plaid's mission is to unlock financial freedom for everyone.

plaid.com

info@plaid.com

PLAID HEADQUARTERS
1098 HARRISON ST.
SAN FRANCISCO, CA 94103