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Headwinds and Tailwinds for Fintech In Equipment Financing

By Levon Goukasian, PhD, and Bill Ullman

Financial technology, or fintech, has emerged as a sub-industry to the financial services industry. It offers marketplaces for financial transactions, alternative data collection and analysis, and much more. This article explains the factors and trends that have helped fintech evolve, discusses regulatory issues and developments, and offers various corporate strategies for incumbents.

Using Artificial Intelligence Technology to Remain Competitive in a Fintech Environment

By William S. Veatch

Recent developments in mathematics, logic, and data science are leading to advances in artificial intelligence and the law. Speed and efficiency are paramount to the new breed of lessors and lessees, and data is king. This article explains the benefits to lessors that embrace the new technology to remain competitive. The appendix offers a primer on logic, both traditional and the Boolean lattice, to illustrate how leasing attorneys may be performing their jobs in the future.

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Headwinds and Tailwinds for Fintech in Equipment Financing

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Financial technology, or fintech, has emerged as a sub-industry to the financial services industry. It offers marketplaces for financial transactions, alternative data collection and analysis, and much more. This article explains the factors and trends that have helped fintech evolve, discusses regulatory issues and developments, and offers various corporate strategies for incumbents.

Technology is shaking the foundations of traditional businesses, including financial services. A new type of competition is emerging from the financial technology, or fintech, sector. The rise of the fintech sector is a global trend, reaching both developed and developing economies.

Fintech describes the evolving intersection of financial services and technology. Fintechs integrate finance and technology in ways that disrupt traditional financial models and businesses and provide new services, or access to services to businesses and consumers, and do so with significantly lower cost. Fintech disruptors are expanding into online lending, alternative data collection and analysis, credit underwriting, digital deposits, mobile payments, wealth management, robo-advising, and other areas of the financial services industry.

Emerging technologies such as cognitive computing (CC), machine learning (ML), artificial intelligence (AI), and distributed ledger technologies (DLT) have the potential to change the financial services industry. They are used by fintechs as well as by established incumbent financial institutions (incumbents).

FACTORS BEHIND THE FINTECH EVOLUTION

Wide-scale tech disruption is happening in many industries, including the financial services industry. Recent advances in online encryption technologies, such as cybersecurity, e-signing, electronic funding and electronic or mobile payments, have empowered fintechs to underwrite and manage financing risk and their operations on a highly automated basis.

One of the factors behind fintechs' successful evolution is their ability to collect and process data from internet-based sources, including social networking sites and third-party credit-scoring agencies. Fintechs also use sophisticated algorithms to make faster credit decisions than traditional scoring agencies using manual underwriting.

Below we summarize some of the most important factors and trends that have contributed to the successful evolution of fintech and its penetration into the financial services industry:

Favorable Economic Environment

The post-crisis economic environment of low interest rates, the economic recovery from the recession, and low delinquencies of consumer loans made alternative investments in online lending platforms, with potentially higher yields, attractive to yield-searching investors.

Changing Demographics and Consumer Behavior

Millennials, the "digital natives" generation, have strong preferences for online or mobile platforms, automated processes, and transparency of data and information. Millennials also have a perception that peer-to-peer (P2P) or multi-lender

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Editor's note: This article is based on a Foundation research report titled Headwinds, Undercurrents, and Tailwinds: How Equipment Finance Companies Can Learn and Benefit from the Fintech Phenomenon, *published in February 2018. It is available at www.leasefoundation.org.*

marketplace (MPL) lending is of greater social value than conventional banking.

> Fintech lenders often use information in credit underwriting algorithms that comes from nontraditional sources, such as information from social networking sites.

Big Data, Cloud Technology, and Automation

These factors are driving cost advantage and ease of use and have helped make credit determination and funding decisions faster. They encompass social networks, advances in analytics, big data analytics, cloud technologies, mobile accessibility, electronic applications, marketplace funding models, e-signatures, e-documentation, and proprietary credit-scoring algorithms.

Fintech lenders often use information in credit underwriting algorithms that comes from nontraditional sources, such as information from social networking sites (not used by traditional banks in their lending decisions).

Some fintech lenders have developed their own online lending platforms that use big data in their own proprietary algorithms to evaluate the credit risk of borrowers. Through this new approach to credit risk evaluation, some consumers, who would otherwise be underserved, potentially could get access to funding.

Regulatory Advantage

Most MPLs, being largely unregulated, can operate with almost no regulatory overhead. MPLs enjoy the "regulatory arbitrage" in the sense that traditional financial service companies have high barriers to entry, such as state licensure laws, capital requirements, and regulatory compliance, but MPLs are not directly regulated.[1] This allows them to successfully compete with incumbents or even to be in an advantageous position by comparison.

Serving an Underserved Market

Many fintechs entered the marketplace to provide financing to those small businesses (or individuals) that could not get funding from traditional incumbent lenders in the post-crisis time period because of the flight to quality.

FINTECH ECOSYSTEM

The online lending market has evolved rapidly over the last decade and continues in its growth trajectory. Fintechs approach financial services from a technology and customer experience perspective. Many of them have focused on payments.

Digital ecosystems or marketplaces operate in nonpayment spaces, providing platforms for merchants and consumers. For these firms, the focus is on financial transactions occurring within their own marketplace. Some of the digital ecosystems operate balance sheet lending, peer-to-peer lending, or multi-lending platforms.

Another category is data providers such as Equifax, FICO, Orchard Platform, PeerIQ, and PayNet. These companies facilitate new lending activity by providing access to new data sources or by aggregating data on the online lending industry.

Balance sheet lenders. These are companies that lend directly from their balance sheet and retain the loans and their risks. This model of lending has yielded to another one, a hybrid model of lending, in which fintechs borrow from other sources of capital to lend on their platforms.

Peer-to-peer marketplaces. The P2P model was established in the consumer lending market, to match investors with borrowers. As P2P small business lending evolved over time, the market became dominated by institutional investors and P2P and B2B marketplaces were born.

Multi-lender marketplaces. Another emerging online segment in small business lending is multi-lender marketplaces, in which small business borrowers can comparison shop among many loan offerings. These loans can be offered by alternative lenders or even traditional lenders. These MPLs are helping consumers in their search for the best source of funding, by offering the convenience of seeing most offers in one place to compare, select, and fund.

Payments/e-commerce platforms. Existing payments or e-commerce platforms are entering into the online lending market, by targeting small business loans (for now). These platforms are offering loans to their existing small business customers.

Invoice financing. Invoice financing is a process by which businesses can receive payment up front for outstanding invoices.

Data providers. Alternative lending platforms or fintechs apply new underwriting practices that use data from sources that would not be used by the traditional banks, thus making faster credit decisions and in many cases widening their scope of customers to include underserved ones. There are new types of data providers — to either platforms or to institutional investors — that collect, compile, and standardize data and then provide it to others for decisionmaking.

UNDERCURRENTS

Recent advances in online encryption technologies, cybersecurity, documentation preparation, e-signing, and electronic

funding and payments have created an environment for fintechs to grow and penetrate the financial services industry. The ongoing fintech disruption is built on the following undercurrents:

- A lower-cost operating model due to lack of regulatory overhead or other costs, such as loan processing or servicing costs. Most fintechs are not regulated, and therefore they do not have the regulatory overhead burden. Because of this lack of regulations, the barrier to entry has been very low for fintechs.
- The ability to use alternative data and sophisticated credit scoring algorithms to make the credit determination and funding decisions faster.
- Superior customer experience, driven by speed and convenience, as a result of incorporation of technological innovations.
- The low-interest rate environment since the financial crisis of 2008.
- Timing: Fntech developments have happened during the expansionary part of the business cycle, where delinquencies have been low, the risk appetite has been increasing, and there have been shortages in high-yielding investment opportunities.
- Strong investor demand for online-originated loans due to their high yields. This has been fueled by credit agencies' involvement with MPL asset-backed security transactions, such as DBRS and Moody's ratings of CommonBond's loans and Kroll's rating of Lending Club's MPLs, which increases the credibility of online-originated loans.
- Innovations in and availability of new technologies.
- Shifts in consumer preferences toward virtual Banking 2.0, Banking as a Platform (API), and mobile banking.

FINTECH RISKS

Marketplace lending is evolving so rapidly that it is difficult to make predictions about its more mature state. As with any new and untested market, there are such issues as lack of performance histories through full economic cycles, financial stability, operational risks, or its ability to comply with new and ongoing regulatory requirements such as the Financial CHOICE Act or the fintech bill introduced by Congressman Patrick McHenry. (These are described below in Ongoing Regulatory Changes.)

Lack of Performance Histories Through Full Economic Cycles

How will the fintech industry perform in high interest-rate environments? In an economic slowdown? In a credit or liquidity crisis? Development of risk measures and risk management tools — especially under the scenario of substantial increases of default rates in a major business downtum — are important for the long-term survival and growth of the industry.

Unlike more traditional lenders, the marketplace lending business model heavily relies on loan originations and the subsequent sales of the loans. Generally, the primary sources of marketplace platform providers' revenue are the loan-origination fees and loan-servicing fees.

In case of a major economic downturn, a massive number of loan defaults could result in large losses for fintech, and that could easily exhaust any default reserve funds that they might have.

The financial services industry needs both to quantify the risks of losses in case of a downturn and to educate investors about these risks. Not only will servicing revenue be lost due to a rising number of defaults but loan origination fees will also be adversely affected.

Loan originations could decline or even be interrupted for other reasons, too, including regulatory restrictions, lack of investor interest, increased competition, or loss of a relationship with the originating partner institutions. Potential decline of loan-origination fees will likely limit revenue and, in turn, lead to operational difficulties for marketplace platform providers.

In more established sectors, historical data from various economic and business cycles help to better anticipate collateral performance and compare individual pool performance with that of the whole sector or a typical benchmark pool. The marketplace lending sector, however, is relatively new and untested in business cycles.

OTHER RISKS

Several other forms of risk merit describing.

Operational Risks

Potential credit risk concepts should be considered here: risks of platform failure, bankruptcy following large financial losses, or the possibility of operational failure.

Unlike more traditional lenders, the marketplace lending business model heavily relies on loan originations and the subsequent sales of the loans.

Regulation

The objective of regulators is to ensure appropriate oversight without blocking financial innovation and the use of MPL platforms to provide credit to borrowers that are unable to borrow from traditional lenders. However, the uncertainty about future regulations or deregulations (depending on the political parties in control) may hurt the innovative developments in this market.

Cybersecurity Risk

Cybercrime is at an all-time high for financial services, and cyber-

The key to assessing the impact of rising interest rates on fintechs is to estimate what part of the cost of funds for fintech is interest-rate sensitive. That is, what part of the overall cost will be impacted due to rising interest rates?

attacks are more sophisticated than ever. Although fintech offers real benefits and efficiencies to individuals or small businesses, it also creates security vulnerabilities and new risks — cybersecurity risks — for consumers of digital financial services. Fraud, cybersecurity, and money-laundering operations are three other situations that require MPL platforms' readiness, to prevent such actions and comply with regulations.

Monetary Policy: Tightening of Credit

The Federal Reserve System is expected to tighten monetary policy over the coming years. The Fed Funds Futures at the CME Group price-in multiple interest rate increases in the near future, and such changes will affect cost of capital and access to capital for fintechs.

MPLs had low operating costs and relatively low customer acquisition costs because of the low interest rate environment in the last nine years. But this cost advantage may quickly diminish depending on the interest rate environment; therefore, we analyze the impact further below.

The key to assessing the impact of rising interest rates on fintechs is to estimate what part of the cost of funds for fintech is interest-rate sensitive. That is, what part of the overall cost will be impacted due to rising interest rates?

Deloitte, in a recent report, "Marketplace Lending: A Temporary Phenomenon?" examined the costs incurred in originating and servicing a loan through the traditional bank model with an equivalent loan that was originated and serviced through online lenders. Deloitte's analysis does not compare the total costs of operating a bank to the total costs of operating an MPL. It analyzes only the cost of funding an unsecured personal loan at banks and at MPLs, in both the current environment and in a hypothetical higher interest-rate environment. The findings suggest that:

1. The total funding costs for banks are lower than for MPLs.
2. The non-interest-rate-sensitive component of an MPL's funding profile is proportionately lower than it is for a bank. Therefore, MPLs' costs will rise significantly more than banks' costs, 25% versus 13%, as interest rates increase.

Thus, these estimates and analysis demonstrate the higher sensitivity of MPL-generated loans to interest rate increases compared to loans originated by the banks.

FINTECH-RELATED REGULATIONS

The growth of fintech is challenging regulators to create new regulations to meet the demands of the growing industry. The fintech industry in the United States attracts a sizable number of investments. As it becomes a crucial part of the financial system, the largely unregulated nature of fintech at some point is likely to invite regulatory scrutiny.

The marketplace lending industry has been subject to recent cautionary guidance issued by many federal regulators. (Examples are the Consumer Financial Protection Board, or CFPB, releasing a request to explore the impact of alternative data sources in 2017, and the OCC's recent white paper, "Supporting Responsible Innovation in the Federal Banking System.") While the regulating agencies have acknowledged the potential benefits of online lenders to consumers, they have also pointed to certain risks, particularly as related to fair lending and compliance with the Equal Credit Opportunity Act (ECOA).

Consumer loans are highly regulated. Loans made through the online platforms are subject to extensive rules and regulations, entailing licensing and examination by federal, state, and local governments. For example, regulation limits the loan fees, requires many forms of disclosures, and imposes licensing requirements on lenders.

Many lending platforms collect data from borrowers' social networking activities and apply that data to their proprietary algorithms to determine borrowers' creditworthiness, which may not be compliant with the ECOA. The Department of the Treasury's May 2016 report on marketplace lending referenced the use of alternative data in underwriting by marketplace lenders as an area of both promise and risk.[2]

Traditional lenders, on the other hand, use credit scores from the established credit agencies or other information that is not related to the borrowers' characters, and they therefore are compliant with the ECOA.

ONGOING REGULATORY CHANGES

Although there currently is no comprehensive regulation of online marketplace lending in the United States, lenders are subject to various federal and state laws and regulations. These include federal and state consumer-protection statutes and regulations, lender and broker licensing and usury laws, data-privacy laws, and securities regulation.

Consumer Financial Protection Bureau

In 2017 the CFPB released a request for information to explore the impact of alternative data sources, including data from mobile phones, rent payment histories, electronic transactions such as deposits, withdrawals and transfers, building credit histories and increasing credit access. The potential risks posed by these data sources are of concern because they may be biased and could have an adverse impact on credit access to low-income and underserved communities.

Madden v. Midland

On June 27, 2016, the U.S. Supreme Court declined to hear the case of *Madden v. Midland Funding LLC*, letting stand the decision of the U.S. Court of Appeals for the Second Circuit that the National Bank Act does not protect against state usury law claims if the bank's assignee is not located in the state in which the loan was originated. The Second Circuit Court of Appeals reversed a century of "valid when made" precedent by letting a state apply its interest rate cap to a loan made in another state that was bought by a third party.

The U.S. House of Representatives recently passed H.R. 3299, the Protecting Consumers' Access to Credit Act of 2017. This act ensures that bank loans that fall within the maximum rate of interest allowable under federal law when made will remain valid regardless of whether a bank subsequently sells or assigns the loan to a third party.

This bill, now with the Senate Banking Committee, essentially overturns the Second Circuit's ruling in *Madden*.

Financial CHOICE Act

The U.S. House of Representatives passed the Financial CHOICE Act in 2017. The FCA repeals financial regulations harming consumers, investors, and entrepreneurs. Moreover, it helps to clear the regulatory uncertainty about peer-to-peer lending. The FCA includes many bills that help startups and small businesses access the capital they need to launch, scale, and compete. The bill also clears barriers in the financial technology sector. The FCA has direct potential effects on securitizations, marketplace lending, and commercial lending.

Fintech Bill

Congressman Patrick McHenry, vice chair of the House Financial Services Committee, has introduced the Financial Services Innovation Act of 2016, which is intended to provide a streamlined regulatory process for innovative fintech products and greater certainty about compliance requirements.

The federal agencies covered by the bill include the CFPB, Federal Reserve, Federal Deposit Insurance Corp., National Credit Insurance Administration, Office of the Comptroller of the Currency, Federal Trade Commission, and Office of Housing and Urban Development.

Innovation Initiative

The Office of the Comptroller of the Currency issued a white paper, "Supporting Responsible Innovation in the Federal Banking System," in March 2016, in which the OCC solicited feedback on its innovation initiative to develop a comprehensive framework to identify and understand trends and innovations in the financial services industry.

Special Purpose National Bank Charter

On December 2, 2016, the OCC announced its plans to move forward with a proposal to consider applications from fintechs to receive charters as special purpose national banks. The OCC's white paper expresses three reasons why the agency believes it is in the public interest to provide the special interest charter. They are to ensure that fintech companies operate "in a safe and sound manner," to promote "consistency" in governing law and regulation, and to "make the federal banking system stronger."

This proposal is significant for the fintech sector because a national bank charter could relieve fintechs of needing to register or obtain licenses in various states, with their differing sets of laws and restrictions.

There are, however, questions about how the fintech banking charter would change the market, particularly considering capital adequacy and compliance requirements. There is also an open question whether a bank charter would constrain the innovation that has differentiated the fintech industry from the traditional banking industry.

The Second Circuit Court of Appeals reversed a century of "valid when made" precedent by letting a state apply its interest rate cap to a loan made in another state that was bought by a third party.

In addition, a national bank charter will not help the fintech industry to obtain more stable funding unless fintechs are permitted to take deposits, which would require regulatory oversight by the FDIC.

Deregulation

There is a widespread belief that the Trump administration may reduce existing regulations in the financial services industry. Assuming no other changes in industry regulations, deregulation will be positive for the early-stage fintechs because they will not have (almost any) regulatory barriers to entry. The administration's goal is to reduce the financial burden on banks by

repealing and reducing various provisions of the Dodd-Frank Act, replacing them with new policies and regulations.

Even though fintechs may cause potential threat to incumbents, they also create opportunities for them to differentiate themselves and become more competitive.

Deregulation in the banking sector, however, will also reduce any regulatory arbitrage that fintech companies have been enjoying for some time, compared to their more established incumbents. However, while the possibility of deregulation in the whole financial services industry is expected, fintechs may be subject to new regulations for consumer protection purposes.

CORPORATE STRATEGIES

In a report published by the Economist Intelligence Unit titled "The Disruption of Banking," more than100 senior bankers and 100 fintech executives were interviewed to predict the future of the banking industry over the next five years.

When bankers were asked how fintech may disrupt the banking industry, more than 90% of them believed that fintech firms will have a significant impact on the future of banking, with more than one-third believing that fintech will gain a share equal to the incumbents (24%) or an even larger share of the market (20%).

When asked about banking industry's response to the fintech challenge, a majority of bankers (54%) believed that banks are either ignoring the challenge or that they "talk about disruption, but are not making changes."

Should the incumbents respond to fintech disruption attempts? How should they respond? What are some of the suggested strategies for them to follow? It is our opinion that the lenders that will be best positioned to face ongoing marketplace disruptors are those that take advantage of technological advances and invest in them, as part of their corporate strategies for growth, and gain of more market share, through a more efficient and more customer-oriented approach, equipped with disruptive business models.

Strategic partnerships are among the most promising ways for incumbent financial institutions to work with technology innovators to strengthen and improve existing business models, and keep or increase market share. For incumbent financial institutions, a suggested strategy would be to utilize alternative lenders' technologies for speedy online application, origination, underwriting, and servicing of loans.

Even though fintechs may cause potential threat to incumbents, they also create opportunities for them to differentiate themselves and become more competitive. To improve their operational efficiency, not only can incumbents form joint ventures with them or acquire the fintech firms but they also can learn from fintechs and adopt their new technologies.

So how can market participants, both incumbents and fintechs, best adapt themselves to the competition?

Following EY 2017 findings and suggestions from 2017, we compile a list of corporate strategies for incumbents and provide the pros and cons of these suggested strategies, to deal with the ongoing fintech disruption.

- **Strategy 1: Invest in fintech.** Banks and other companies invest in fintechs many different ways, such as creating their own venture capital or strategic investment arms. (e.g., GV, formerly Google Ventures, investing in tech startups, including fintech).
- **Strategy 2: Partner with fintechs.** Banks enter into various types of partnerships with fintechs, such as the use of their platforms. They may partner with fintechs to develop new technologies or to refer unqualified (to the incumbent) applicants to their fintech partners.
- **Strategy 3: Develop technologies in house.** Although most banks have plans for facing fintech competition, another of their strategies is internal innovation. Banks are accelerating their in-house development of fin-technologies.
- **Strategy 4: Merge with or acquire a fintech.** Acquiring or merging with a fintech company can increase a bank's digital presence. Acquisitions have also become a common trend for large financial companies.
- **Strategy 5: Join a fintech program with other incumbents.** Some of the biggest banks in the United States joined forces to create the so-called clearXchange network a few years ago. Now known as Zelle, it is a platform that allows consumers to transfer funds from their bank accounts to another person's bank account using a mobile device. It has grown to include many smaller banks or credit unions.

It is not an easy task to determine the superiority of any of the above five strategies. The decision depends on the pros and cons of the strategies under consideration that are relevant to the firm.

FINTECH IN EQUIPMENT LOANS AND LEASES

In 2015, total public and private investment in equipment and software totaled $1.5 trillion, of which 68% or $1.02 tril-

lion was financed, according to an estimate based on data from IHS Markit and the U.S. Department of Commerce Bureau of Economic Analysis. Of the 68% of equipment that was financed in 2015, 39% was leased, 16% used a secured loan, and 13% used a line of credit (LOC). Banks, Captives, and Independents financed only about $270 billion of all equipment purchases.

By the estimates of ELFA's U.S. Equipment Finance Market Study: 2016–2017, the total investment in equipment and software is expected to grow to $1.8 trillion by 2020, of which about $1.2 trillion is expected to be financed. Given the (relatively low) rate of financing by Banks, Captives, and Independents, this provides opportunities to new (fintech) entrants to penetrate this market and capture market share by providing financing to the underserved market.

We studied the potential of fintechs to penetrate the equipment loan market either by serving the underserved market or by gaining market share by refinancing existing equipment loans.

We estimate the size of the equipment loans and leases market that is susceptible to refinancing to be under $5 billion — which is less than 4% of the total amount of new business origination in FY 2016.

Thus, using our estimates (based on subjective metrics that would determine susceptibility of loans to refinancing by third parties, including fintechs), we find that the existing equipment loan market is not very susceptible to disruption.

It is estimated that about 43% of the $1.6 trillion equipment purchases — about $688 billion — is financed by cash, credit cards, or LOCs. While that 43% seems to be a sizable market for penetration by fintechs, and probably a part of it could potentially be tapped by fintech lenders, it is difficult to apply our criteria or otherwise estimate the size of this market (cash, LOC, and so on) that is susceptible to financing by fintechs.

There are many unknowns here, such as the characteristics of cash buyers, that would not allow us to estimate the possibility of fintech penetration. One important characteristic could be cash buyers' risk aversion, which may make their opportunity cost lower than the potential financing costs (even for prime borrowers). For such risk-averse borrowers, it may be challenging for fintechs to offer services or even attractive rates to change their purchase-financing decisions.

LOC-funded equipment acquisitions, however, could potentially be disrupted by fintechs, given that they are frequently refinanced with a permanent equipment loan. Bank leasing companies accommodate equipment purchase transactions first through the bank LOC, then shift it to a permanent lease/loan upon project completion.

What about the future business of the incumbent Banks, Captives, and Independents?

Since the banks finance the majority of the equipment loans, we will consider the banks as incumbents and compare them with fintech disruptors. When considering the next five years, we will use a more "normalized" credit environment, which means higher interest rates.

Thus, assuming the rates increase, we would compare how fintechs will fare against the banks in gaining market share in the equipment financing area. Fintechs do not have much room to disrupt the banks in the equipment financing area. In the case of higher interest rates, we think the banks will have more cost advantages and therefore will be better positioned to keep the expected market share (barring a fintech-disruption threat).

OTHER TECH IN EQUIPMENT LOANS AND LEASES

Other technology-related disruptions of the equipment research/purchase/financing market should be considered when analyzing fintech disruption of the equipment loan market. For example, new companies are developing and implementing innovative technologies or new business processes that improve operations and enhance customer experience. Some of the new (tech) companies are digitizing various aspects of logistics, including booking transportation and finding warehouse space.

Some fintechs are creating platforms to connect buyers to vendors and financing companies, in addition to origination systems, credit scoring, pricing, decisionmaking, documentation, and so on. Mintaka Financial is an example of such a company. Other tech companies are focusing on online shopping, financing, and e-documentation as well as on improving the customer experience by speeding the entire process of buying and funding the purchase.

> Since the banks finance the majority of the equipment loans, we will consider the banks as incumbents and compare them with fintech disruptors.

Fintech disruptors also impact the means by which business is processed, by offering such services as document fulfillment, digitization, document storage, payment processing, and credit decisioning, thus improving the operating efficiencies of existing equipment finance companies.

Thus, technology (or fintech) companies are actively pursuing their entry to the equipment market, by targeting all related areas — researching, purchasing, origination, funding, or identification of marketplaces for used equipment. Therefore, there are areas that fintechs can penetrate (and have already), and there are areas that are not prone to fintech penetration.

While the equipment financing industry is not as susceptible to fintech disruption through refinancing, there could be threats to the industry affecting retention of existing or future business.

New tech developments — those that make equipment research, purchase, funding, servicing, or remarketing and reselling more convenient, effective, efficient, faster, and less expensive — have the potential to penetrate the equipment financing market and possibly take away market share from those incumbents that do not respond to the changing environment in a timely manner.

However, those incumbents that act in a timely manner, taking appropriate steps to have strategies in place to hedge against such disruptive forces, will be well positioned to retain their current or anticipated future market share.

CONCLUSION

Fintech companies take the latest developments and innovations and commercialize them in the equipment loan and lease industry. They thus make operations more effective and efficient, improve customer experience, and provide convenience during the entire researching, buying, funding, servicing, remarketing, and reselling process.

To a certain extent, there is a threat to fintech disruption for the incumbents in the financial services industry, but we do not believe that fintech could be so disruptive as to become the main source of funding.

While the fintech disruption may not threaten incumbents with the loss of most of their market share, nevertheless incumbents should act to hedge the risks of losing their market share to fintech disruptors.

To hedge the risk of losing existing business, the corporate strategy of any incumbent, whether a financing company, a manufacturer, or a vendor, should be to closely follow the developments in new and potentially disruptive technologies, adapt them, or invest in them in a timely manner.

Those incumbents that act in a timely manner and have strategies in place — to hedge against the risks of losing business that result from not operating to match with the new and disruptive technological developments — will be well positioned not only to retain their current business share but also gain more market share in the future.

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Endnotes

1. Some of the marketplace lenders' regulatory advantage comes from working with issuing banks, such as WebBank or Cross River Bank, and effectively outsourcing the regulatory compliance to WebBank or Cross River Bank, which are regulated financial institutions.

2. U.S. Treasury, "Opportunities and Challenges in Online Marketplace Lending" (May 2016), available at https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf.

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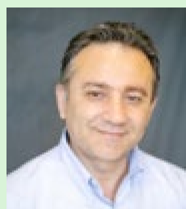

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