

The Changing Bank Marketplace

Since the financial crisis, technology and regulation have been the primary drivers of a changing bank marketplace. More consumers are conducting bank transactions on their mobile phones at an accelerating rate and their need to walk into a branch has steadily declined. Moreover, Dodd-Frank and other banking regulations are causing financial institutions to invest in more compliance personnel and allocate increased capital in reserves to meet these standards. Whether these new regulations is correct policy or not, is still up for debate. But one thing is certain and that is the latest regulations are hamstringing community banks ability to stay in business. These are the local banks that value and cherish the face-to-face relationship with its customers. There is no question that regulation was warranted after multiple bank failures during the financial crisis, yet its timing with the profound advancement in technology is having a negative effect on community banks while pushing consumers into contemporary alternatives.

The major banking regulation, Dodd-Frank Wall Street Reform and Consumer Protection Act was passed in July 2010. Since that time, 103 banks in Texas are no longer in operation (2015). This is not due to failure or incompetent management, but to increased compliance costs from Dodd-Frank. Granted many of these banks were sold and the branches remain open albeit under a different name, but it is the local community who loses out. As smaller banks close up shop or sell to larger institutions, the community loses on two fronts. First, a long-time trusted steward of the community's assets is no longer there or has diminished sway in

regards to decisions impacting the community. This is the individual on the local chamber of commerce or school board who has keen insight into the area, is open to help out, and has a stake in seeing his or her community grow. Secondly, community banks provide critical lending support to the local economy that account for more than 60% of all small business loans under \$1 million and more than 75% of all agricultural loans (Williston). Loans like these are the foundation for a prosperous middle class, which all communities strive for. As smaller banks vanish or are acquired, the result is less emphasis for the acquirer to focus and invest in that community, leaving small-business owners and the community at large with less access to capital and depositors with fewer choices.

Americans despise fewer choices, but when the 800-pound gorilla of regulation handcuffs one spectrum of the industry, it opens up the other side to potential opportunities and innovation. Financial technology has rapidly taken advantage of gaps in the market to provide consumers' alternative options, while exposing holes in the business model of traditional banking. The timing could not have been more perfect as technology's potential has been seemingly endless while consumers adapt and prefer to utilize more of it. This opportunity has launched a proliferation of online banks and other financial-tech start-ups. Some of these businesses are Ally or Live Oak Bank that provide deposit, lending, and other services to consumers through an online-only platform. Others are companies who provide business loans based on a 5-question underwriting criterion all done online. The success of these new entrants can be attributed to substantially lower overhead costs, since these companies have essentially no branches, a focused centerpiece

service, and economies of scale. Attractive features like these have spurred investors to pump capital into financial technology start-ups, allowing these companies to compete with traditional banks very quickly. In comparison, many small and community banks were slow to adapt, and had to double-down on their technology budget to catch up to offer similar online and mobile services. Financial-tech companies have revealed that much of traditional banking can be done outside a branch from a customer's home or through his or her own mobile phone.

Consumers wouldn't put their money into financial tech companies over a traditional bank if there were no benefits. The eye-catching appeal online banks have over traditional banks is simple, it's the fees and rates. Due to their cost structure, online-only banks can offer more competitive products such as free checking, ATM rebates, and higher rates on savings accounts. Since smart-phones today are essentially a bank in one's pocket capable of depositing checks, transferring money, and checking balances, many consumers never need to walk into a bank. Therefore, these features appeal broadly to price-conscious consumers.

Although many community banks have caught up with offering their own smart-phone branded applications, new fin-tech companies are taking aim at small business lending as well. For example, OnDeck Capital is an online small business lender touting their ability to fund loans within hours compared to days or weeks for traditional banks. Online lenders like this have sprouted up, because technology has made it possible to process loan applications online, without a loan officer ever having to meet the borrower. This ability stems from their proprietary assessment of creditworthiness using data traditional banks don't typically use. Small business

owners resort to online lenders, because of either being declined from a local bank or frustration with the timeliness and burden of processing a traditional loan.

However, as fast and easy online-lending companies promote themselves to be, consumers need to be aware of how online lenders differ from community banks. First and foremost, when a small business owner requests a loan from a community bank they will be greeted by a loan officer who will get to know them and their business. This personal interaction helps the officer understand the business, assess and mitigate risk, and allows the prospective borrower to ask any questions he or she may have about the loan. In comparison, a loan originated via online will be much less personal and quite possibly rushed without the borrower fully understanding the terms. Secondly, the interest rates for online lenders are not even in the same ballpark as community banks. While community banks charge on average anywhere between 100-500 basis points above prime, online lenders' rates are exorbitantly higher. According to the Wall Street Journal, OnDeck Capital's average annual rate of interest stood at 43% as of 2015 (Rudegear). Rates like these are hard to justify, but business owner's still need to do their due diligence before taking on any debt, whether from an online lender or a community bank.

Ultimately, consumers will be the deciding factor as to how the banking landscape settles. On one side, many forward-thinkers believe there will be no need for physical bank locations, as consumers will conduct everything online. Already, 52% of smartphone owners with a bank account reported using mobile banking (Innovation). In opposition, others believe physical locations serve an important purpose being located within the community they serve. There is no better way for

a bank to mitigate risk than personally knowing the business and character of a borrower. This has yet to be managed through an online only platform. Difficult regulation will be adapted to or whittled down to allow community banks to sustain and persevere. What remains clear is that technology has proven to be highly beneficial and is moving very fast. Community banks and all traditional banks for that matter will have to offer more technology-enhanced services to remain competitive in today's changing bank marketplace.

Works Cited

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