SMALL-BUSINESS LENDING: NEW STRATEGIES AT COMMUNITY BANKS

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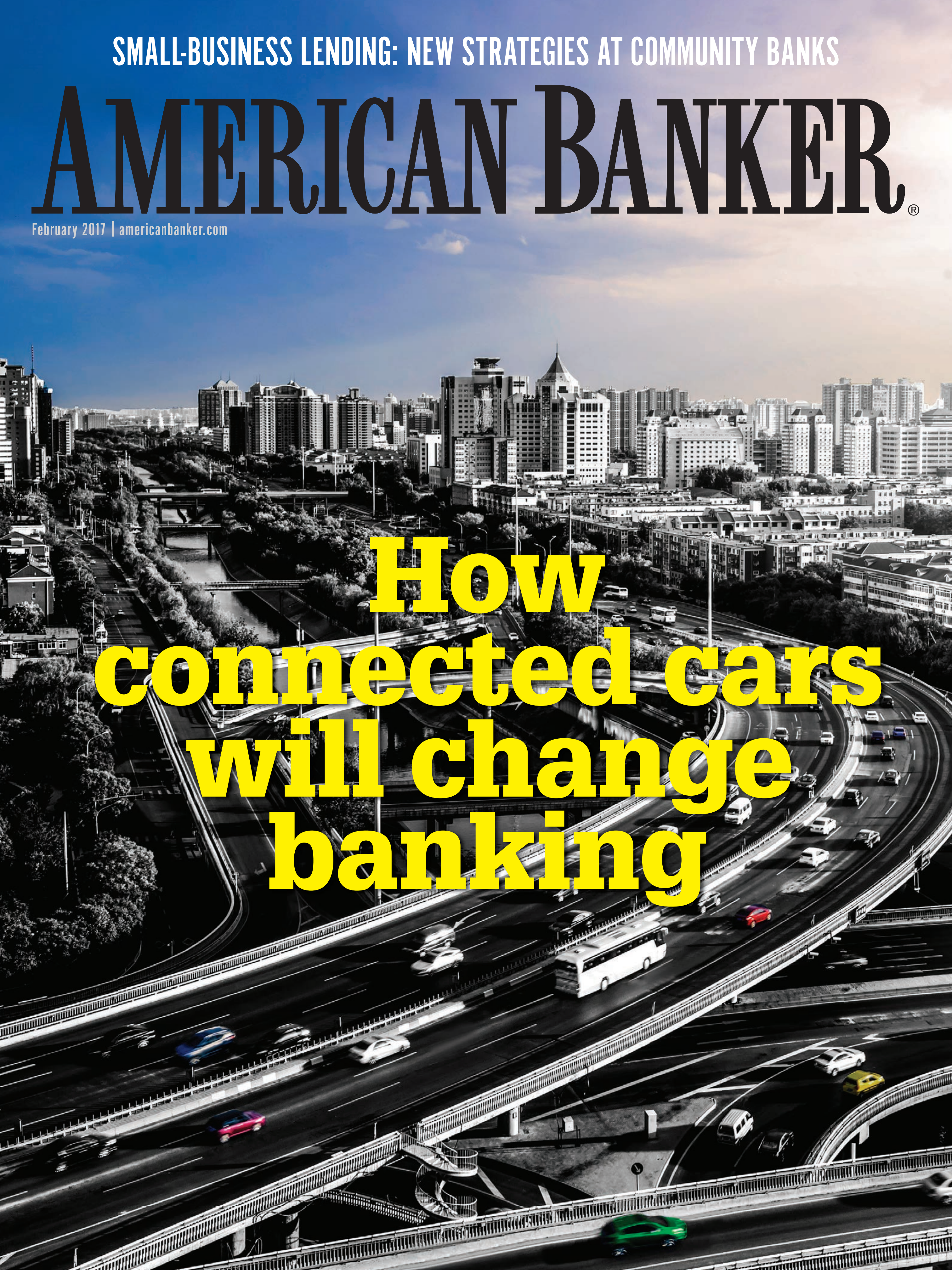

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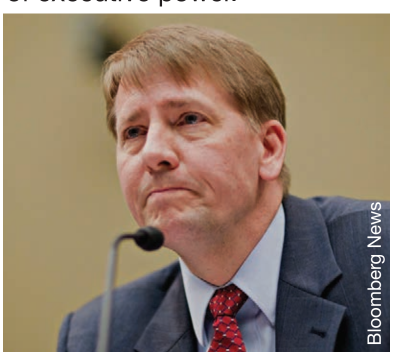
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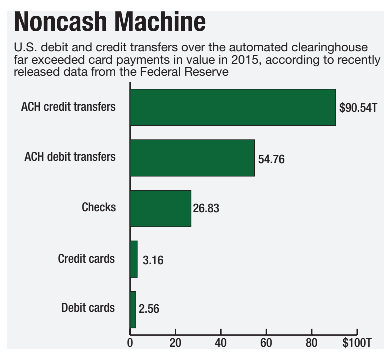

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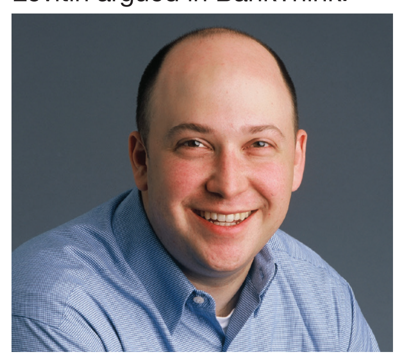

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Editor's Note

BY BONNIE McGEER

From Automated Driving To Automated Payments?

The Consumer Electronics Show in Las Vegas – where all kinds of technology is unveiled every January – does not get a lot of attention from bankers. But maybe it should, given some of the announcements from automakers at the event this year.

Imagine a future where cars are like personal assistants for daily living – giving advice on how to become a better driver, how to stay more relaxed behind the wheel, what songs to listen to, and which route to drive, depending on your mood, schedule, stress level, or all of the above.

This is already starting to happen, thanks to connectivity that links vehicles to servers in the cloud. And cars with such advanced capabilities portend new revenue streams, not just for automakers, but also for financial services providers, as we explore in our cover story in this issue.

Consider what automakers like Ford, Toyota and smart had to say about the initiatives they have underway.

Ford announced that its vehicles will soon allow drivers to use Amazon's Alexa – similar to Apple's Siri – to listen to audiobooks on the road, request news, play music, add items to Amazon shopping lists and more.

How the use of Alexa in vehicles could evolve is open to the imagination. A future iteration could encompass mobile payments of one type or another – perhaps at gas pumps, drive-thru windows, or parking garages.

General Motors uses diagnostic algorithms and cloud computing to predict and preempt parts failures for a few basic components under the hood, including the battery and fuel pump. If something seems wonky, the system will email or text the owner to get the part replaced before it fails and causes someone to be left stranded.

Another take on this technology comes from Toyota, which announced a new telematics system at CES. Its system will connect Toyota vehicles to a preferred dealer so that when maintenance or repairs need to be scheduled, customers can contact the dealer through the screen on the center console and send vehicle diagnostic data.

It is conceivable that these services could evolve to include the payment. After the mechanic finishes the job, the payment could happen automatically through cloud services connected to the car. No need for pulling out a wallet or swiping a credit card.

Smart, a division of Daimler, announced at CES that it will soon start testing a new program that allows the owners of its cars to participate in private car sharing – which also has implications for banks.

The initiative, called "smart ready to share," is aimed not only at young people, but also small-business owners, who can use it to manage vehicle fleets.

"What we are launching here is nothing less than the Airbnb of the car sector," said Annette Winkler, CEO of smart, in a press release announcing the program.

The system uses a smartphone app and requires a small "connectivity box" be added inside each car at the base of the windshield (available as an option on new models and as a retrofit to existing ones).

The owner of the car sets times during which it is available to others to drive and invites people to use it – just friends and colleagues for the initial beta test, but ostensibly anyone once the program launches in earnest.

People who fit criteria set by the owner can then book time using the app and open the door with their smartphone. A key must be left inside to allow for driving. The vehicle is later returned to a predefined area set by the owner.

Though smart is absorbing the cost of the beta test, including that of additional insurance required for users, the idea is that customers will eventually be able to use the car-sharing program to defray all the costs of ownership, with the app helping determine what rates to charge.

Another interesting idea smart recently started testing, called "ready to drop," uses the same connectivity box at the base of the windshield to allow DHL delivery reps to unlock a car and drop off a package in the trunk for the owner to retrieve later – a handy solution to the problem of not being around to accept it in person.

Services like this also could involve facilitating a payment at some future point.

"We are working intensively on the question of how cars can help make people's lives easier. If the car receives parcels, customers have more time to do things they really enjoy," said Dieter Zetsche, chairman of the board of management at Daimler.

Check out the cover story for a deeper analysis of what the emerging technology in the auto sector means for banks. □

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Briefings

SMALL BUSINESS | STUDENT LOANS | LAW & REGULATION

The Need for Speed in Small-Business Lending

Achieving faster turnaround times can make these loans more profitable for banks, so Stonegate considers it an imperative

By John Reosti

OF ALL THE THINGS DAVE SELESKI wants to do at his bank this year, none ranks higher than slashing origination costs for small-business loans.

"Making it attractive to where a lender can handle a $200,000 loan request without having to spend hours and hours underwriting and preparing it – that's really what our focus is in 2017," said Seleski, the chief executive of Stonegate Bank in Pompano Beach, Fla. "I've got a huge project list, but as we've gotten bigger, it's moved up the rankings significantly."

Seleski views the issue through the prism of time required to underwrite a credit. Right now, the number of hours falls somewhere between 36 and 48 – way too many, he said.

"When you're a small community bank, you kind of treat every client the same. As you get bigger, you've got to come up with some efficiency," Seleski said. "It's taking the same amount of time to underwrite a $100,000 loan as a $10 million loan. That doesn't make any sense."

If reducing the approval time on small-business loans is not a priority at other community banks, it should be, said Charles Wendel, the president of Financial Institutions Consulting in New York.

With a $100,000 loan, "the typical bank is either making no money or breaking even," Wendel said. Making such small loans profitable is very difficult because of all the fixed costs, "and if anything costs are going up."

Wendel estimates that banks can lose as much as $600 a year on a $100,000 loan. As a result, "many banks have moved away from lending to small companies or making small loans," he said. "That's a problem because small business needs banks and banks need small business."

Seleski, 51, founded Stonegate in March 2005 with a single branch. In the years since, he's built it into a $3 billion-asset regional bank with 23 branches dotting South Florida's coast.

Stonegate has not done badly at all for a startup, remaining profitable even during the financial crisis. Through the first nine months of 2016, it earned $19.9 million, up 12% over the same nine-month period in 2015.

But its returns on assets and equity, at 1.04% and 8.75% respectively, are both slightly below average for banks with $1 billion to $10 billion of assets, according to statistics from the Federal Deposit Insurance Corp. That's due in part to substandard returns on small-business loans.

"It's just critical we take the amount of man-hours we're spending on these loans and reduce them dramatically," Seleski said.

His plan is straightforward: automate as much of the lending process as possible using software from a vendor.

The goal is to be able to deliver an answer on loan applications in less than two weeks. As things stand, it can take more than twice as long to give a yes or no, Seleski said.

But for many smaller banks, the kinds of off-the-shelf software programs Stonegate is evaluating might be too expensive. "If you digitize your process and take a lot of the hand-holding out of it, that would lower the cost. Problem is, most banks are incapable of doing that," Wendel said. "It takes a lot of time, money and expertise. Small banks don't have any of those things."

For these banks, the answer may lie in a partnership of some sort with nonbank small-business lenders or technology providers, Wendel said. The collaboration could take the form of a "white-label" approach where an alternative lender, operating behind the scenes, evaluates prospective borrowers and provides credit to those that fail to meet the bank's underwriting standards. Or a bank could license a company's technology platform to lend online, Wendell said.

The $452 million-asset Sutton Bank in Attica, Ohio, took that approach, when it partnered last year with RCGiltner Services of Louisville, Ky., to launch a digital platform that enables it to speed up approval and delivery of business loans under $50,000.

But Seleski sees fintech lenders as more of a threat. "Fintech is getting to be a bigger competitor," he said. "Once they figure out their funding side, it's going to be very difficult to compete with them."

The growth of these lenders is one of the factors pushing Seleski to make process improvements.

"If they can give an answer to somebody in 48 to 72 hours – albeit at a higher price – I think we've got to speed up our response time," he said.

Co-Signer's Remorse

Student-debt burden grows for parents, grandparents

THE FACE OF U.S. STUDENT LOAN debt is usually an underemployed twentysomething. But increasingly, the burden of paying for higher education is shifting to their parents and grandparents instead.

In a new report, the Consumer Financial Protection Bureau details some troubling findings regarding the rising student debt owed by people in the later stages of life.

Perhaps most worrying is that these older borrowers are having much more difficulty making their payments than younger borrowers are. The report finds that 37% of federal student loan borrowers who are 65 or older are in default, compared with 17% of borrowers under the age of 50.

What's more, the proportion of delinquent student loan debt that is held by borrowers ages 60 and above rose from 7.4% in 2005 to 12.5% in 2012. Americans ages 60 and older owe roughly 5.4% of all student loan debt, up from just 1.8% about a decade earlier.

"Older student loan borrowers are often ignored," lamented Persis Yu, director of the student loan borrower assistance project at the National Consumer Law Center.

The CFPB report, which compiles the findings of other researchers, carries important implications for both the federal student loan program and for banks that make private student loans. Both face the risk of rising defaults as older Americans stretch thinner to pay for higher education.

As college tuitions have climbed, parents and grandparents of students have been shouldering a larger share of the cost. Often they borrow through a federal program called Parent Plus. The program allows parents to borrow in amounts up to the full cost of tuition, without regard for their ability to repay the loan.

That can be problematic, especially when the borrowers are past their peak earning years.

"You can get a Parent Plus loan if you're poor. You can get a Parent Plus loan if you're poor and in your 60s," said Jason Delisle, a resident fellow at the American Enterprise Institute, a right-leaning think tank.

The CFPB expressed concern that student debt is preventing some older Americans from paying for basic needs in their lives. The agency cited survey data from 2014, which found that 39% of consumers ages 60 and older with a student loan said that they skipped necessary health care needs, compared with 25% of older consumers who do not have student debt.

But Delisle is skeptical of the conclusion that the high delinquency rates mean graying borrowers are all in dire financial straits.

Some older consumers – including many who already own a house and are not terribly concerned about hurting their credit scores – might be making a rational decision not to make payments on student loans, Delisle said. "It may not be entirely a picture of people struggling or overwhelmed by debt, as the CFPB would have it."

Delisle is a critic of the Parent Plus program, but he doubts that Congress will reform it anytime soon, given the political sway of middle-class families that use the program.

If the program were to be scaled back, the beneficiaries would likely include banks that make private loans, since more students and parents would need to look beyond the federal government to finance higher education.

The CFPB report also offers a note of caution regarding the private market, which represents roughly 7.5% of all outstanding U.S. student debt. Since the financial crisis, private lenders have increasingly required borrowers to get a co-signer, in order to increase the likelihood that the debt will be repaid.

The CFPB estimates that 57% of all co-signers are 55 or older, and raises questions about their ability to meet their financial obligations.

"Unlike their younger counterparts, who generally are expected to experience income growth over their lives, older consumers typically experience a decrease in income as they age," the report states.

A lot of co-signers on student loans may fail to comprehend that they are on the hook if the student fails to repay the debt, said Dan Feshbach, president of MeasureOne, a data analytics firm for private student lenders.

"I think the key to this is that co-signers need to understand the responsibility that comes along with co-signing a loan," Feshbach said. *– Kevin Wack*

Bad Actors, Beware

N.Y. Gov. cites Wells Fargo in calling for 'bold steps'

NEW YORK GOV. ANDREW CUOMO IS using the phony-accounts scandal at Wells Fargo as justification to expand the state banking regulator's enforcement powers.

In January, Cuomo unveiled a proposal that would give the New York State Department of Financial Services – widely viewed as one of the nation's most aggressive state regulators – the authority to ban from the industry individual bankers who have harmed consumers through "egregious and deceptive" behavior.

Though the agency has no jurisdiction over Wells, a federally chartered institution, Cuomo mentioned it as an example of why regulators need to be more vigilant in enforcing consumer protection laws. "The excesses and abuses at the center of the Wells Fargo scandal is unacceptable and New York, in its role as a regulator, is seeking to take bold steps" that would bar those responsible for such behavior from banking jobs, he said in a press release.

The proposal suggests the New York regulator is once again positioning itself to take a tougher approach to financial regulation than its federal counterparts.

Federal regulators have the authority to ban bankers from the industry, at both state and nationally chartered banks. Cuomo's proposal would give the state of New York the power to act on its own accord, stepping in to ban bankers where federal agencies choose not to act.

"The state is taking a little more activist approach," said Joseph Simon, partner at the New York law firm Cullen and Dykman.

Simon said he was "surprised" by the proposal given that the legal process for banning bankers is clearly spelled out at the federal level.

"I think many states including New York are frustrated by the federal government or federal agencies not bringing cases against culpable parties," said Denver Edwards, an attorney at Bressler Amery Ross in New York.

The state's superintendent of financial services, Maria Vullo, has followed in the footsteps of her predecessor, Benjamin Lawsky, with an aggressive approach to financial regulation. The agency has unveiled ambitious new cybersecurity rules, which call for strengthening data encryption beyond what federal agencies have proposed. And last year it approved the first U.S.-based exchange of Ether, an emerging cryptocurrency.

According to a press release from the governor's office, his proposal would give the agency the ability to ban bankers from working in New York, following an administrative hearing. No other details were provided.

Bankers are expected to fight the measure. "I have no doubt that there will be a lot of lobbying to curtail this or further define what kind of activities would be considered 'egregious' activities," Edwards said.

The move shows the agency is putting consumer protection at the top of its agenda, Edwards added.

He said the timing of the announcement was significant, in that it came as federal agencies were expected to exercise a lighter touch on enforcement matters under President-elect Donald Trump.

– Kristin Broughton

BankTechnology

Video Banking That's More Than Talking Teller Heads

Small-business owners who are too busy to visit a branch get another option

By Bryan Yurcan

ROYAL BANK OF CANADA IS BETTING on video as the next step in customer relationship management for its small-business customers.

The bank began offering a video chat service for these customers in Canada and in the United States just over a month ago, partnering with the technology provider Vidyo.

The service is meant to be a convenience for busy entrepreneurs and a cost-effective alternative to tellers for the bank.

"One thing about these clients is they are very time-starved; they're focused on building their business," said Claude DeMone, vice president of contact center technology at RBC.

The small-business segment typically needs a lot of hand-holding, but often doesn't add much to the bottom line. The average teller interaction costs a bank about $4, while a meeting with a subject matter expert or personal banker in a branch costs even more, said Ed O'Brien, executive vice president of research and strategy for ath Power Consulting.

"A video meeting is much less expensive and you still have that customer experience on par with what they get in a branch," he said.

For banks, video can bridge the gap between the adoption of self-service digital channels and the benefits of in-person branch interactions. The most common way banks are using video is with interactive teller machines, which allows a remote teller do things like cash a check or dispense cash in denominations not typically available at an ATM.

Though small-business customers often need to speak to a banker in person, they can't always afford the time to visit a branch, so they generally resort to calling the contact center, DeMone said.

Now when they do so, they are given an option to connect by video instead. They are sent a link where they can initiate a video chat with a contact center banker who has been trained in videoconferencing.

Besides the benefits of face-to-face interactions, the video chat function has capabilities not available on a regular phone call, DeMone said. For example, customers can share charts, graphs, spreadsheets and other critical documents with their banker in real time within the video chat.

In the future RBC might embed a video chat option within its business banking app, so a customer can initiate this service with a few taps rather than by dialing in, DeMone said. But the bank wanted to first get the product out to market as fast as possible.

So far customers seem to like it. "It's quick, simple and has worked incredibly well," DeMone said.

O'Brien said the video chat idea is especially well suited to small-business customers, who are often underserved by banks. Interactions that happen with a banker in person tend to lead to more engagement, so being able to use video to bring those interactions to customers who can't make it into a branch can be valuable, he said.

RBC is considering expanding the service to other types of customers in 2017. But DeMone said the bank will be judicious in how it deploys video chat.

"Not every action lends itself to video," he said. "Some are better served by text chat, some by in-person interactions, some by phone. We're going to look at what offers the most value to our different customers."

Silicon Valley Weighs In

Why tech giants like Apple and Google care about the screen-scraping debate

THOUGH THE ISSUE OF SCREEN scraping has long pitted banks against fintech companies, another powerful interest group is starting to weigh in now: Silicon Valley.

That dynamic is set to make it one of the policy debates bankers need to watch closely this year.

"It's really important" that access to bank account data not be blocked, said Brian Peters, the executive director of Financial Innovation Now, an advocacy group that represents Amazon, Apple, Google, Intuit and PayPal. "It's up to the consumer to decide what technology they want to use and what level of privacy and security they want."

At issue is the process of gathering financial data on users by getting their permission and login information to access their account. Companies like Yodlee and Mint have turned screen scraping into a valuable service for consumers.

But banks have raised concerns over screen scraping, citing worries about cybersecurity and privacy. Last year several large banks were accused of denying screen scrapers entry into their systems.

When consumers share the login credentials they use for their bank accounts, "they're sort of opening the barn doors and you can't put the horse back in," said Rob Morgan, the vice president of emerging technologies at the American Bankers Association.

If Silicon Valley enters the debate in force, it might tip the scales in the debate.

Peters has urged the incoming administration to adopt fintech-friendly policies. Financial data is among the group's top priorities.

The large tech companies are depicting their position as a defense of consumer options. Banks, meanwhile, say they are not trying to block consumers from using the applications they like. Rather, the intent is to protect consumers' data.

"You need rules in place where you can trust that the data is being protected," once it leaves the bank, Morgan said.

Regulators appear ready to side with the fintech industry. In a stark warning to banks, the Consumer Financial Protection Bureau explicitly said in October that consumers should be able to give permission for third parties to access their financial information.

The CFPB has even opened the door to issuing new rules by requesting public comment on the issue of financial data access.

Observers predict these early skirmishes are going to turn into a long, drawn-out war over ownership and control of financial data.

"Right now, technology companies – with a few exceptions – don't get a lot of specific data about your overall financial life or your financial capability from their dealings with you," said Todd Baker, the managing principal at Broadmoor Consulting. "They would love to have that information. Their whole business model is based on what they know about you."

The gold rush for financial data is already underway in Silicon Valley.

"Technology companies are trying to integrate financial services into their products," said Pratin Vallabhaneni, an associate at Arnold & Porter.

With the rise of the Internet of Things – which describes connected objects like FitBit and Amazon Echo – the line between generic online data and traditionally more secure financial information is thinning.

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It's easy to imagine a multitasking, all-knowing evolution of a voice assistant like Alexa in the Amazon Echo. In the future Alexa theoretically could have access to millions of data points, including transactional data, credit score history and upcoming mortgage payments.

"You can say, 'Assistant, open my blinds!' It will do that," Vallabhaneni said. "And you can say, 'Assistant, what is my bank balance?' and it will also do that. ...

"As younger people get really comfortable with receiving personal money management, banking and retirement advice not from a human being in an office but through digital means, one can imagine that there's an audience for something like this."

Companies and their lawyers are still working to determine what laws govern financial data once it has left a bank's systems. Though it is likely not to be covered by laws and regulations affecting banks – like the Gramm-Leach-Bliley Act – it could be subject to a patchwork of state consumer protection and privacy laws.

The question is complicated by the fact that data is being passed along from the bank to the intermediary to the consumer-facing fintech company. It is unclear whether customer disclosures are required at every step.

"A lot of firms are exploring how to do this and there aren't necessarily standard market practices right now," Vallabhaneni said.

Some observers warn that current laws governing consumer data rights might not be adapted yet for a big migration of financial data.

"A regulatory scheme should be created to ensure that the current system – one mindless click and you give away all your rights to personal data – wouldn't happen anymore," Baker said.

Beyond the haggling over consumer rights and privacy issues, financial data is a business asset that banks and tech companies likely will do battle over for many years to come.

"What Google and other large tech companies would like to do would be to turn banks into just a utility, by making sure that they are just those processing the transactions," Baker said. "All the customer interactions and all the true value is in the front end. The big technology companies would like to own the front end."

Today, banks and tech companies can find at least one area for common ground. They say screen scraping is not a viable option in the long run. The movement is toward application programming interfaces instead.

"There's a lot of agreement between banks, data aggregators and customers on where we want to get to," Morgan said. "There are better ways forward than sharing login credentials."

– Lalita Clozel

A Real-Time Challenge

Same-day ACH payments complicate fraud prevention

FASTER ACH PAYMENTS ARE TAXING banks' ability to check for fraud and criminals are taking notice.

As of September, credit-based payments through the Automated Clearing House system started being settled within the same day. These are transactions where one entity is pushing money from their bank account to another. Examples include direct deposit, payroll, person-to-person and vendor payments.

Where before banks had two to five days to analyze suspicious transactions, now in some cases they have only two hours. So ensuring sufficient scrutiny has become more of a challenge.

"Recently we've seen more evidence of incidences of ACH fraud than we have in the past," said Andrew Davies, a vice president at Fiserv who helps financial institutions worldwide spot potentially illegal transactions.

Davies has seen recent cases of malicious software tampering with ACH files to perpetrate fraud. For instance, hackers are manipulating payroll files and adding themselves as fake employees to collect money.

Money lost this way will be difficult to recover.

"Anytime you push money out, it's really hard to pull it back," said Ruston Miles, founder and chief innovation officer of Bluefin Payment Systems, a payment processor. For instance, "if it's a payroll file, the money has been pushed out, and you can't go out to the customer and pull it back."

A lot of fraud monitoring is still done manually, Miles said.

"Most banks have electronic fraud detection systems that catch transactions that don't look right and put them in an exception bin, and these banks employ floors of people who inspect the flagged transactions," Miles said. "With same-day, all that time gets crunched down," so either more people have to be added or the bank has to be more picky about what gets flagged.

In a faster-ACH-payments world, the bank account number becomes more powerful because it can be turned into cash more quickly.

To date, bank account numbers have been worth less than credit card numbers in the black market because they've been harder to use.

With same-day settlement, fraudsters will be able to use bank account numbers to make real-time purchases, such as software, movie and song downloads, and receive the items before a bank can stop them.

"If fraud starts really going there and merchants start losing, merchants will either have to add anti-fraud detection systems themselves or they may turn away from ACH payments for any real-time or near-real-time transfers, because they can't be assured of the funds," Miles said

–Penny Crosman

California Crackdown

Online payday lenders suffer another blow

EFFORTS TO REIN IN HIGH-COST online payday lenders are paying off.

The most recent example is a California Supreme Court decision that could prove fatal to the practice of Native American tribes offering consumer credit in the state without a license. In a Dec. 22 ruling, the court said that two lenders with tribal affiliations are not entitled to sovereign immunity and much comply with state interest rate caps.

But even before that, consumer advocates and their allies in state government had notched some key victories.

A report by the Center for Financial Services Innovation in November found that the online payday loan market shrunk by 22.5% between 2014 and 2015. The report projected that the sector would contract by another 9.9% over the next year.

“I think the tribal payday lending model is totally on the way out,” said Lauren Saunders, associate director of the National Consumer Law Center.

One key factor in the decline of online payday lending may be steps that search engine companies such as Google have taken. Since July, the Mountain View, Calif., search giant has banned ads for loans with annual percentage rates of 36% or higher, or where repayment is due within 60 days.

The state of California also has been working with Google, Microsoft and Yahoo to block online ads by unlicensed payday lenders in the Golden State.

Under a legal doctrine known as sovereign immunity, tribes have sometimes been able to get around state licensing requirements. The tribes often establish affiliated companies that make the loans.

But in its December ruling, the California court found that the Miami Tribe of Oklahoma and the Santee Nation of Nebraska exercised little control over the daily operations of the lending affiliates. The court concluded that the affiliates were largely run by people who were not members of the tribes and were not entitled to tribal sovereign immunity. It also laid out a detailed legal test for determining whether these sorts of business arrangements pass muster. *– Kevin Wack*

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Four ways the CONNECTED CAR will change BANKING

From frictionless payments to improved underwriting models, connected cars will rewrite the rules for how and where banks interact with their customers and change the way consumers manage and spend their money

By Brian Patrick Eha

If you think Americans have a love affair with cars now, just wait until people begin to treat them not merely as a means of transportation but as smartphones on wheels – or robot servants.

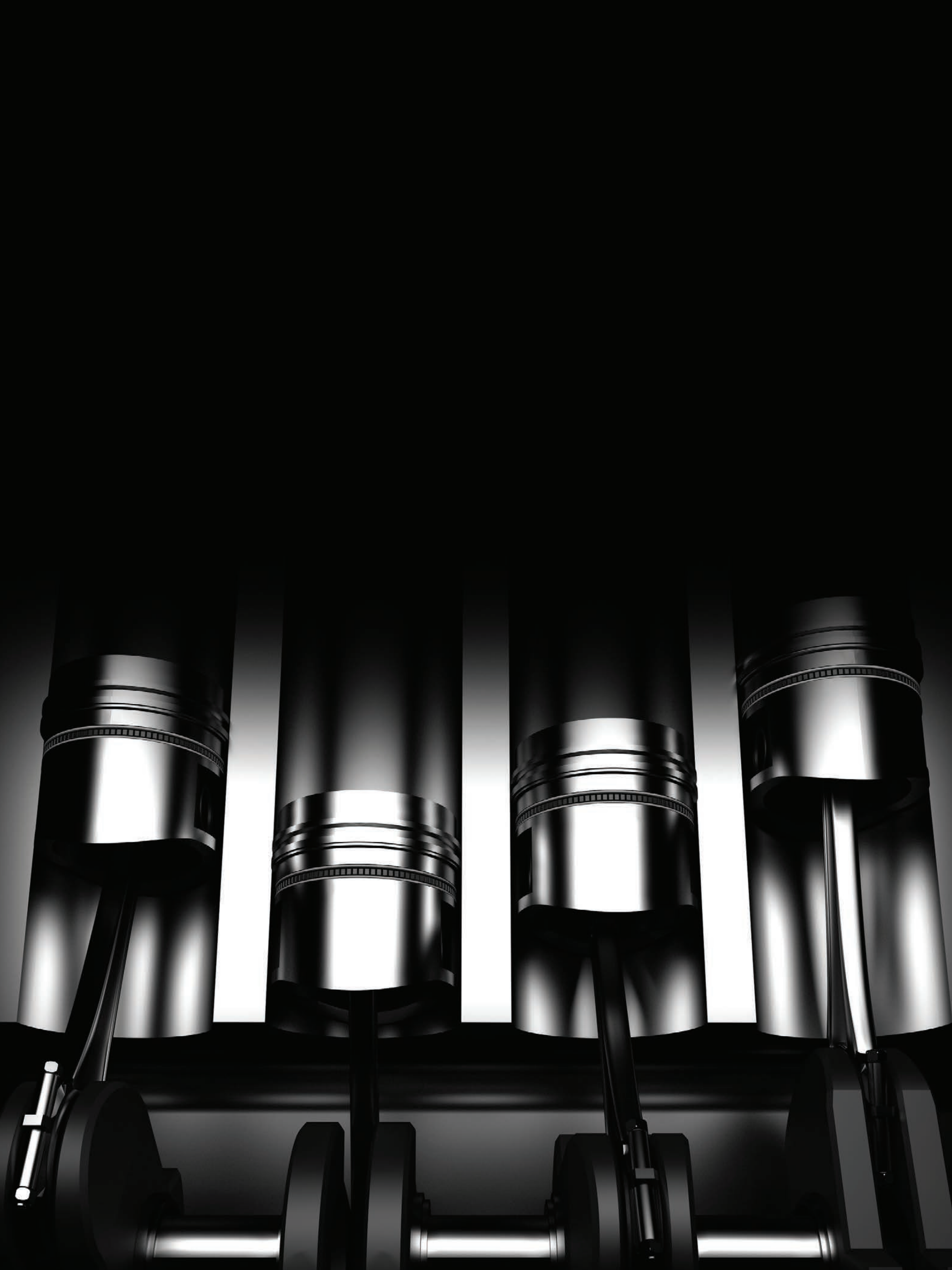
Automobiles are more wired than ever. But experts say the late-model cars on the road today are just a precursor to truly connected cars. In the near future this next generation of cars – loaded with sensors and screens, feeding back to third parties huge amounts of data on vehicle performance and even driver behavior – will communicate with other devices, be loaded with apps and even make their own decisions.

While for now the smart car is lagging behind the smart home, automobile manufacturers, technology firms, ride-hailing companies and financial institutions are on course to integrate automobiles into the burgeoning Internet of Things. In the process they intend to revolutionize transportation and the fabric of people's daily lives.

"The car is going to be an extension of who you are, just like the phone is," said Suresh Ramamurthi, the chairman and chief technology officer of CBW Bank, a small bank in Weir, Kan., that has attracted a national client base of fintech startups.

In the more distant future, the car may become something greater still: an autonomous agent that can carry out tasks and authorize payments without requiring its owner's input. It may even have its own bank account.

The revolution in automotive technology and mobility services will be a financial revolution as well. From frictionless payments to improved underwriting models, connected cars will rewrite the rules for how and where banks interact with their



customers and change the way people manage and spend their money.

As in the days when mobile banking came into vogue, ignoring the trend is not an option, said Jeremy Carlson, a principal analyst at IHS Automotive. "Technology overall is changing everything about our lives very, very quickly. And the car, and transportation, and mobility, are part of that."

The new mobility landscape ushered in by connected cars will produce both winners and losers – among financial institutions as well as automakers. What is an opportunity for a forward-looking bank such as CBW may be a risk to others that are slow to adapt.

What follows are four areas in which the connected car looks set to impact, if not outright transform, the world of finance.

1 PAYMENTS

This is the big one, the one everybody thinks of. If the car becomes a smartphone, then it's a no-brainer to bring mobile – truly mobile–payments to everybody's morning commute. Ramamurthi predicts that cars in the near future will store profiles of their drivers, mapping their routines and streamlining everything that requires a payment along the way, whether it's paying a toll or buying a cup of coffee at a drive-thru.

Five to seven years from now, cars and gas pumps will be able to communicate with each other, said Brett King, the co-founder and chief executive of the mobile banking startup Moven and the author of "Augmented: Life in the Smart Lane." The car will negotiate the payment for you; no more pulling out plastic or fumbling for spare change. The same goes for toll roads and parking garages.

"The ability to lower the friction by having the car talk to that environment and make a payment on your behalf is a fairly obvious use case," King said.

Banks are working on just this sort of technology. In December 2016, at a U.S. Bancorp hackathon devoted to applications for the Internet of Things, one of the teams conceptualized a smart-vehicle capability that would allow a car to pay automatically for drive-thru orders. U.S. Bank's chief innovation officer, Dominic Venturo, had no trouble seeing the benefits. "From an issuing perspective, the more places we enable customers that have a payment card with us to use their card, the better for" U.S. Bank, he said.

While the hackathon version used the phone as a bridge to the car to demonstrate the potential, the idea is that the payment credentials ultimately would be stored in the car itself. When it's time to pay, a message might pop up on the navigation system: "OK to pay $12.95?"

This would be quite an improvement from mobile payments today, when trying to use Apple Pay at a drive-thru usually requires an employee to "literally hand you a point-of-sale device through the window," said Venturo.

While Carlson cautions that such solutions won't appear overnight – or be universal right from the start – some companies are already working on multipartner solutions. A case in point is the BuyWay platform being developed by the payments technology firm FIS and SAP, the German software multinational, to allow consumers to pay for gas from their connected cars.

Once all fuel pumps have been made "more addressable," FIS and others will be free to build a variety of apps and mobile wallets that interact with the pumps, said Doug Brown, the head of FIS Mobile. Some consumers may be loyal to BP, for instance, and will opt to use the BP app and earn loyalty rewards. Others would rather use their in-car bank app for every refueling and will visit gas stations simply based on price or convenience.

Unlike many initiatives from banks and payments companies, BuyWay is no mere proof of concept. The go-to-market version is slated to roll out sometime this year. Brown said that some major fuel providers have already gotten on board, though he declined to name names.

When Accenture partnered with Visa in 2015 to develop a proof of concept for connected-car payments, refueling was one of three key use cases – along with quick-service restaurants and parking – chosen to demonstrate how they might work. The demo used onboard diagnostics and Bluetooth beacons to allow an in-car app to communicate with a gas pump, which together determined the amount of fuel needed and enabled payment with a touch on the dashboard.

The success of that demonstration led Visa to begin working in earnest, alongside partners such as Accenture and Samsung, to integrate Visa payments into Internet of Things devices, including automobiles.

While much of the technology to make such payments a reality exists, "it's not just about the technology," said Richard Meszaros, the connected-commerce lead at Accenture. "It's about the ecosystem that needs to be part of this user experience. The car may have the technology, but if the car can't talk to the fuel pump it doesn't matter. There is a network effect [that has to happen] here."

Ramamurthi is already working on even more sophisticated car-based payments. With connected cars providing "intimate feedback" about driver behavior as well as the location and condition of the vehicles themselves, he said, it will be possible to contextually determine a payment across multiple dimensions, including location, time, amount and frequency.

"You could say, 'I'm only going to let my daughter eat ice cream once a week,'" he said. "I can do crazy things. Once you control four or five dimensions, the inter-

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section of those dimensions is a particular use case."

The owner of a fleet of trucks who has a partnership with Shell Oil, for instance, could ensure that his drivers only filled up at Shell gas stations. The bank that enables that kind of contextual payment will get the business, Ramamurthi said. His other company, Yantra Financial Technologies, has developed a digital platform that allows client banks to design products and services involving contextual payments.

Driverless cars will likely bring even more radical changes – and such vehicles are no longer the stuff of science fiction. Uber began ferrying passengers in self-driving cars as part of a pilot program in Pittsburgh in September, though the vehicles still had humans at the wheel who could take over driving if needed.

A fully autonomous vehicle equipped with its own payment credentials could pick up and pay for groceries independently. It could earn money as a taxi while its owner was at work. If it ran on electric power – as most do – it could take itself to a recharging station when it was low on energy and pay the fee.

"It sort of gives a new meaning to the term automobile, because it truly is automated," said Dave Schwab, an executive in the Accenture's connected-commerce practice. "As they become autonomous, they become agents that can go do valuable things for us."

Anthony Levandowski, who leads Uber's driverless-car team, recently told the Financial Times that a human driver is still necessary as a fail-safe because its technology "is effectively not good enough to be an autonomous vehicle yet." But once the technology has been perfected, and people begin to cede control to driverless cars – not only over their mobility but over their finances – it could be the beginning of a new era for payments.

With much of consumers' payment activity automated, and with intelligent agents conducting commerce on people's behalf, "the current value of payment systems – rewards and points and miles – kind of breaks down," said King. "Banks will need to have a very different view of the way they enable those experiences." They may get only one shot to win over a customer–at the point when the customer is selecting the payment method that will underlie his autonomous vehicle's transactions.

Banks, then, will have to create new payment products that offer compelling reasons for why they should be linked to customers' cars. Whatever form such a product takes, King said he feels certain that "it's not going to be plastic. It's not going to be a credit card."

BANKING ON THE GO

2

Connected cars will allow drivers for the first time to manage their finances from behind the wheel. Brian Pearce, the head of business development for Wells Fargo Virtual Channels, has dedicated himself to anticipating, as he puts it, "the next mobile banking, the next tablet banking, the next Apple Watch banking" – and he says banking from one's car is the next big thing. Drivers will be able to check their balances, pay their bills, move money and perform other simple transactions.

The nature of American society makes this not only possible but practically inevitable. The U.S. is a car country, as observers both foreign and American have long noted. The Census Bureau found that 86% of U.S. workers commuted to work by car in 2013, and some 75% of them drove alone.

"We know that customers spend a lot of time in their cars," Pearce said, "and we know that a lot of those trips they're actually by themselves." The question, then, is what sort of banking app they would want to use behind the wheel.

Wells Fargo has spent the past couple of years trying to find the answer. Pearce says his team acquired some early versions of in-dash software kits and has done some prototyping, though it isn't ready to announce anything yet.

There are challenges to developing an app for connected cars. Banking while driving has to be not only hands-free but eyes-free, allowing drivers to stay focused on the road. "When we got the software it came with a pretty thick binder of rules and regulations" regarding what sort of app his team could and couldn't build, Pearce said.

The solution likely will involve a voice-activated interface and perhaps a "smart assistant" along the lines of Amazon's Alexa or Apple's Siri. Just as such virtual assistants are finding a place in people's homes, so King believes artificial intelligence will be a core component of the connected car.

FIS's Brown agrees. Auto, he said, is "just another extension" of the Internet of Things, "a new place where people will want to access and manage money."

Ford in early January announced that it would become the first automaker to integrate Amazon's Alexa into its cars. While banking with Alexa is not yet possible, the virtual assistant will be able to provide the weather forecast and search for nearby gas stations on command. Consumers who have an Amazon Echo smart speaker at home will even be able to turn their cars' engines on or off or check their battery levels from indoors.

As a next step, Brown wants carmakers to open up their application program interfaces so that a voice biometric can be developed – a way of authorizing and authenticating transactions with your voice alone, without giving out sensitive information. "You can't be saying a PIN or something out loud while someone else is in the car," he said. And then, too, it shouldn't be the case that just anybody who gets into the car – your child, a valet – can ask about your account balance.

Wells Fargo is likewise applying lessons from the connected home to automobiles. Brown's concerns about privacy were studied by Pearce and his team in an experiment with smart-television technology. The issue was how to display a low-balance alert on a customer's TV while ensuring that others don't see it.

Context matters too, Pearce said. Is the car parked? If so, a touchscreen interface would be viable. Are other people in the car? The way a car owner wants the app to function when commuting or running errands by herself might be very different from how she wants it to function when driving a carful of kids to a weekend soccer game.

The advent of fully autonomous vehicles may eliminate some of these concerns, such as the need not to distract drivers. Once drivers become passengers, they will be free to perform more complicated transactions or digest more information during their ride. Venturo gives the example of a corporate client who wants his cash position reported to him while his autonomous car drives him to work.

Deva Annamalai, the director of innovation at Fiserv, sees other possibilities. "More advanced interactions like videoconferencing with a bank loan officer or investment adviser may require the help of an autonomous car, where the car takes over most of the driving functions," he said. "But as long as a car has a screen and appropriate connectivity, these types of interactions are not out of the question."

For now, banks and other companies are focused on improving the experience for human drivers. It may be a while before they get it right. Pearce points out that when smartphones first appeared, banking and finance apps were not part of the first wave of apps to be developed.

"They came along once people started to realize the capabilities that were available, and then customers started to demand: 'I love having my smartphone to play games and do these other things; I wish I could do my banking on this device,' " he said. "And suddenly we have this urgent need to deliver banking. I think the connected-car space will evolve very similarly."

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The inflection point for banking while driving is probably still a year or two away, Pearce estimates. Apple and Google have both launched operating systems for in-dash players. Some manufacturers even offer after-market options to retrofit customers' vehicles with a dashboard interface – a sign that such technology is beginning to go mainstream.

"You're just now seeing those dashboards become more open ecosystems and you're just now seeing people start to have experiences where they're putting apps on their dashboards," Pearce said. "Now that the major phone operating systems have established a sort of beachhead in the connected-car market, I think we're going to see a bunch of innovation in this space over the next two years."

3 UNDERWRITING AND FINANCING

As consumers' relationships to their vehicles change, banks will need to rethink how they work with vehicle owners. "Today," said Venturo, "we think of a car as a 'one human, one vehicle' thing," and auto finance reflects this quintessentially American attitude: 95% of loans and leases go to consumers.

That has been a plush business model for banks, captive auto lenders and dealers alike. According to Experian, the average auto loan topped $30,000 for the first time in the first quarter of 2016.

But the future may lie in shared mobility resources. As the popularity of ride-hailing and ride-sharing services continues to grow, and the auto industry edges ever closer to truly autonomous cars, the belief that nearly every American is going to own a car someday is beginning to break down.

As a result, automakers are experimenting with new ownership models. Ford launched a pilot program in Austin, Texas, one year ago allowing groups of three to six people to lease a vehicle together. Hyundai announced in late 2016 that it would offer drivers 24- or 36-month "subscriptions" as a way of owning the company's new Ioniq electric car. And in January, Cadillac launched a program in New York City that gives members on-demand access to the company's full slate of cars as an alternative to owning at all. The company already has plans to expand the program to other cities.

At the same time, Volkswagen, which sunk $300 million into an Uber competitor called Gett last May, is launching a new ride-hailing service in Rwanda – a market that Uber has not yet penetrated.

"Large auto-tech companies are recognizing that they need to get in the game of innovation," said Matt Trotter, the managing director of San Francisco-based Silicon Valley Bank, which serves dozens of startups focusing on the future of transportation.

This sea change – from full vehicle ownership to joint custody, from driving oneself to hailing a ride – could hit lenders hard. A report from Deloitte last year predicted that the $116 billion-a-year auto financing market could, in the next 10 to 15 years, shrink by as much as 50%, with 35% of the remaining financing going to commercial vehicle fleets rather than consumer automobiles.

Indeed, there are early signs of such a shift. Uber created a leasing company as a wholly owned subsidiary in 2015, and it now accounts for double-digit percentages of total sales at some dealerships – enough to have its own showrooms, according to CNBC. Uber's financing is fueled by a $1 billion credit facility provided by Goldman Sachs, Citigroup, JPMorgan, Deutsche Bank, Morgan Stanley and SunTrust.

For drivers who want to own, Uber is able to tap its partnerships with major carmakers to secure discounts of as much as $5,000.

"In the coming years," Tim Russi, the head of auto lending at Ally Financial, said last February, "we might be supporting the mobility services industry [rather than] the auto industry."

But while that may hurt lenders' bottom line, the future of transportation also could provide new business opportunities. For instance, while most new car loans and leases today are originated through dealerships, a connected car with a touchscreen interface could allow customers to arrange financing through the vehicle itself on the dealer floor, said Accenture's Meszaros. That would let banks interact directly with customers to provide information on their offerings, rather than being so reliant on a dealership's finance office.

What's more, the arrival of fully autonomous vehicles may actually prop up private car ownership – at least to some extent – because it would mean that "owning an automobile has finally become a good investment opportunity rather than a bad one," Annamalai said. Banks could provide loans to buy self-driving cars, which could then be used for ride-sharing services – earning money for their owners when the owners weren't using them.

"In fact, the next generation of customers [does] not even have to have full ownership in a car," he added. "More than a few people can share joint ownership of the car and use it as needed. ... Banks can facilitate this sharing-economy model and lease a fleet of vehicles among their customers, thereby providing a value-added service."

The underwriting of car loans also appears poised to change dramatically. For now, many automakers want to own the data provided by cars' onboard sensors, but that could soon change. It will be established that customers own the data on their driving habits, and they will be able to share – indeed, may be required to share – that data with banks and insurance companies.

As a result, underwriters will get a much better idea of which customers are greater risks than others. "The dynamic use of that sensor data is going to be far more powerful" than current underwriting practices based on age and demographics, said Moven's King.

He expects companies to transition away from paper-based underwriting models to ones based on driver behavior by the end of the decade. When that happens, hidebound institutions will suffer.

"Insurers that don't have access to sensor data are quickly going to be judged by the market as taking on more risk than they should," King said.


Wells Fargo's Brian Pearce says banking from the car is the next big thing.

4 STARTUP FINANCING AND ADVISORY SERVICES

Another opportunity for banks may lie in financing innovation itself. Social media startups, app makers and other software businesses have traditionally relied mainly on venture capital for funding, since their costs remain relatively modest even as their user bases grow exponentially.

Not so with connected-car startups, said Silicon Valley Bank's Trotter. Companies such as Faraday Future, an intelligent-car startup in San Francisco that unveiled its first production vehicle at the Consumer Electronics Show in Las Vegas in early January, are distinct from the disruptive tech startups of old, he argues, because the costs of hardware manufacturing increase in direct proportion to the size of the business.

Consequently, said Trotter, many of these startups "need their bank to step up in a much larger way to help them scale." Silicon Valley Bank began lending capital to early-stage, venture-backed companies long before most financial institutions would have felt comfortable doing so. Today the San Francisco bank serves about 50 companies in the future-of-mobility space, and has given loans to some of them. "These companies are going to need debt capital to survive," Trotter said. "And it's on us to understand these industries as well as we possibly can, and differentiate between real risk and perceived risk."

Beyond making loans, Silicon Valley Bank strives to play a "connector role" in the startup ecosystem – for instance, introducing client companies to the venture capital arms of GM and Ford, which Annamalai says tend to show interest in connected-car startups. "The goal for us is we want to be more than a bank; we want to add strategic value to the CEOs that we work with," said Trotter.

Still, as with any startups, these companies have no guarantee of success.

"Many banks typically shy away from early-stage funding due to the risks involved," Annamalai said, adding that banks in Silicon Valley may be best suited to making these sorts of investments.

But while Trotter acknowledges that not every bank will want to take a chance on such businesses, Silicon Valley Bank's commitment to engaging with companies on the technological frontier shows how forward-thinking institutions can join their fortunes to that of the pioneers. "We're very deep in the innovation economy, and the health of that ecosystem is what drives our growth," he said.

Another option is for a bank to set up a small-business investment company. Unlike banks' internal venture arms, these funds are exempt from the Bank Holding Company Act, which limits financial institutions to controlling no more than 5% of an outside company.

Propel Venture Partners, the $250 million SBIC backed by BBVA, pursues mainly equity financing, but it has lent money to startups since launching earlier this year. Jay Reinemann, a managing partner of Propel, was quick to mention, however, that the loans have always taken the form of convertible notes – a kind of short-term debt that converts to equity upon the startup reaching some benchmark, usually a major venture funding round.

Lending to early-stage companies requires specialized skills that most banks lack, Reinemann said. It is very different than lending to real estate developers or farmers.

What's more, he added, even many hardware startups are served sufficiently by venture capital firms – and by the few institutions, such as Silicon Valley Bank, that specialize in venture debt – and have no need for traditional banks. The loans involved may also be too small to interest some large commercial banks.

Even so, Reinemann says the onus is on banks to embrace this new business line. Technology is continuing to "eat the world," he said, and lenders outside of Silicon Valley need to start hiring experts who know how to work with promising startups.

"Regardless of where they are in the country, banks have got to start acquiring some skills to underwrite their local technology companies," he said. ☐

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Eastern Bank in Boston built its own online lending platform in hopes of better competing for small-dollar business loans with the likes of Kabbage and OnDeck. But the more lucrative opportunity could be in licensing its technology to other banks

By Kristin Broughton

IN THE SPRING OF 2014, DAN O'MALLEY, a former Capital One executive, joined Eastern Bank in Boston, where one of his first tasks was investigating the emerging threat of online business lenders.

Upstarts such as OnDeck and Kabbage had been getting a lot of attention offering quick-turnaround loans to small-business borrowers – not only in the industry, but from the mainstream press. On the surface, any danger to the 200-year-old Eastern seemed nebulous, as its business loans were growing at a healthy clip. But O'Malley, a data scientist by trade, took a deep dive into the bank's transaction records anyway. What he found was a shocker: About 5% of Eastern's small-business customers at the time were making regular payments to online lenders.

These weren't customers with spotty repayment histories; they included doctors with private practices and sterling credit scores, said O'Malley, the chief development officer at the $10 billion-asset Eastern and head of Eastern Labs, its innovation unit.

O'Malley and his team reached out to Eastern customers who had borrowed from online lenders and learned that many just needed fast infusions of cash – something they didn't think the bank could provide. O'Malley also began surveying Eastern's markets, asking business owners whether they would consider taking out a small-dollar loan if it were available immediately and online. The response was an overwhelming "yes."

So Eastern joined the fray. After building and then testing an online lending platform within its own customer base, the bank formally rolled out its "Express Business Loan" product this past spring. Using a high-tech approach to underwriting, the bank is offering business loans of up to $100,000 that it can approve within minutes and fund the same day.

Eastern has even bigger plans for the coming year. It plans to license its technology to other small and regional banks that have been struggling to figure out how to deal with the online lending trend. This will help Eastern defray the cost of developing the technology. (The bank would not disclose the cost, except to say that it was millions of dollars.)

Eastern already has licensing agreements with two banks – which O'Malley declined to name – and has more deals in the works. The banks will pay a flat fee, as well as a variable charge based on loan volume.

As part of the contract, the banks get access to assorted digital tools from Eastern, including an engine that powers automatic loan decisions, a variety of marketing modules and a dashboard to track performance.

But most important, O'Malley said, such partnerships will help smaller banks compete with not just established players such as OnDeck and Kabbage, but also the larger banks that are muscling into the market.

While community banks have ties to Main Street businesses that give them a competitive advantage, they are at risk of losing some of their best customers unless they upgrade their lending technology, he said.

"We're wildly committed to making our partners a lot of money," O'Malley said.

O'Malley, a former credit card executive, views the dynamics in online business lending as being similar to the credit card market in the early 1990s. Getting a credit card used to be time-consuming and cumbersome. But once high-tech approaches made marketing and approving applications easier, big banks began offering cards on a national scale and quickly took control of the market.

"If you've watched the credit card industry grow up, you've seen this problem before," O'Malley said.

Recent moves by big banks into online small-business lending underscore O'Malley's concerns. This past spring Wells Fargo began offering online small-business loans of up to $35,000 and one of its selling points is speed. It advertises that applicants who get approved will receive their funds as soon as the next business day. JPMorgan Chase also rolled out its offering last year through a white-label agreement with OnDeck, while Regions Financial has been making online loans to businesses in a partnership with Fundation Group since 2015.

A big question is whether there is enough demand to go around. Last year, business loans of $1 million or less accounted for 21% of all loans made by banks, compared with 40% two decades ago, according to research from Karen Mills, a professor at Harvard Business School and former head of the U.S. Small Business Administration.

Experts cite a mix of reasons for the decline, the biggest being a reluctance among small-business owners to expand or buy new real estate. Additionally, businesses that posted a loss during the economic downturn may not have the track record of revenue growth that's necessary to get a bank loan.

Another factor is that the crisis accelerated the decades-long decline in new business formation. Businesses less than one year old accounted for 8% of all employer firms in 2013, compared with 10% in 2007 and 17% in 1977.

"During the recession and after the recession, demand has not been strong," said John Barlow, chief executive of Barlow Research Associates, a market research firm for commercial banking.

Still, when it comes to small-dollar loans – such as those under $100,000 that businesses often use to finance new equipment or pay vendors – research suggests that demand for credit has exceeded what banks are willing to provide. For instance, only 45% of businesses with fewer than 500 employees received the full funding amount they requested from their banks, a 2015 small-business survey from the Federal Reserve found.

That could help explain why total business loans made by nonbank online lenders increased more than 68% in 2015 from a year earlier, to $7.9 billion, according to a report from Morgan Stanley. By 2020, the market for online business loans could exceed $200 billion, the report said.

Eastern explored the idea of partnering with nonbank online lenders before it decided to build its own platform from scratch, but O'Malley said the bank ultimately was not comfortable with their credit policies and quality controls. "We didn't think that they were ready to partner with a bank, in the way that a bank lends," O'Malley said.

Most of the upstart lenders were established in the wake of the crisis, and haven't yet "been through the gauntlet" of a market downturn, he added. Recent trouble in the marketplace lending sector – including OnDeck's struggles to obtaining funding, as a result of rising delinquencies – seem to validate those concerns.

Often the lenders also use complex

algorithms to make credit decisions – a sticking point for bank executives who wanted to clearly understand the criteria used to underwrite local business loans. “Banks need a credit policy – especially in business lending – where they can explain it to a regulator,” O’Malley said.

In place of a complex algorithm, Eastern developed a scorecard that includes a select number of variables, including a business owner’s credit score, annual revenue and industry characteristics. Though community bankers like to pride themselves on relationship-based lending, O’Malley insists that most credit decisions for small-dollar loans are black-and-white assessments of an underlying business model. It makes sense to automate the process.

“It’s not the strength of someone’s grip and the glint in their eye,” O’Malley said. “Where relationship and temperament comes into play is in more complicated loans.”

In total, Eastern approves between 60% and 70% of online loan applications for borrowers who are already Eastern customers, O’Malley said. The approval rate is slightly lower for applicants who are new to the bank.

Eastern declined to specify how much lending volume is coming from online, but O’Malley said the number of applications increased fourfold last year, when compared with the initial rollout to its existing customer base the previous year.

Pricing the loans has been a challenge. Initially Eastern charged between 3% and 5%, a rate that turned out to be too low. “Frankly, we weren’t making much money,” O’Malley said.

In the past few months, Eastern has improved its yield by doubling the interest rate to between 6% and 10% – still cheaper than most credit cards.

As for licensing the platform to other banks, O’Malley so far has drummed up interest mostly by speaking at industry events. He talks about the need for banks to invest in technology and collaborate.

Dan O’Malley says Eastern developed the “Express Business Loan” after learning that 5% of its small-business customers had been making payments to online lenders.

“In the course of doing that, we’ve had banks say, ‘Hey, this is pretty interesting,’ ” O’Malley said.

Still, many community and regional bankers don’t feel any sense of urgency to offer loans online.

In a series of recent interviews, several bankers said that while they are interested in upgrading technology to underwrite or deliver documents more efficiently, they are skeptical about the need to be as speedy as online competitors, particularly if that requires using technology, and perhaps nontraditional data, to make fast decisions about credit.

“I think we all jumped on that worry wagon a couple years ago,” Anne Strange, executive vice president of wholesale banking strategies at the $28 billion-asset First Horizon in Memphis, Tenn., said in discussing the rise of online business lenders.

Taking the time to connect a business owner with the right product is more important to the bank than speed, Strange said.

“Will [we] ever be as fast? Maybe not. But we look for opportunities to help the client get from point A to point B,” and customers appreciate that, she said.

First Horizon does not partner with any online lenders, which Strange attributes partly to its underwriting division setting a high bar partnerships with outside firms.

Other bankers said they are keeping an eye on competition from online business lenders while exploring their options.

“We are actually in the throes of researching” online lending products, said Scott Sanborn, a senior vice president at the $2 billion-asset HarborOne in Brockton, Mass. “We’ve talked with some very large providers in the market.”

Sanborn praised Eastern’s loan product as an “intriguing” fintech approach. But he also downplayed the importance of speed in small-business lending.

“We haven’t found our timing to be a competitive advantage or disadvantage,” Sanborn said.

Other community banks are working on their own innovative approaches to expand into online small-business lending. Live Oak Bancshares in Wilmington, N.C., last year began offering a same-day business loan of up to $350,000. The $2 billion-asset bank has no immediate plans to license its lending technology to other banks; however, it is laying the groundwork to offer its loan through third parties in the coming years, such as through a white-label partnership with equipment distributors.

As O’Malley looks ahead, he says he’s concerned about adding enough staff to meet the demand he expects for the licensing agreements in the coming year.

But he is nonetheless excited.

“I think there’s a huge opportunity to build new technology that’s going to shape the next era of financial services,” O’Malley said. □

A Wish List for the SBA

Donald Trump has nominated Linda McMahon, a co-founder of the World Wrestling Federation, to run the Small Business Administration for the next four years. If confirmed, McMahon, a Republican, will inherit an agency that has supported record loan volume lately, but that many bankers still view as too bureaucratic and inefficient. We asked bankers and small-business advocates what is working well at the SBA, what they would like to see improved, and what else the Trump administration could do to stimulate small-business growth. Here's what they had to say.

JAMES SILLS III

President and CEO

M&F Bancorp, Durham, N.C.

I would like to see the administrator continue to create innovative programs to provide access to capital in urban communities to facilitate growth and self-empowerment. The SBA started the Partnership for Lending in Underserved Markets, or PLUM, initiative in September 2016 in collaboration with the Milken Institute. It is designed to support efforts to more effectively provide capital to minority-owned businesses. It was launched in Baltimore and Los Angeles. We think this initiative is transferable and can be adapted in other cities.

EVAN WESTLAKE

Vice president of commercial lending

Illinois National Bank, Springfield, Ill.

Community bank loan officers now wear so many hats they are unable to become experts in SBA programs. It would be great if the SBA could have more staff dedicated to SBA products and clarify who should be contacted with questions on applications. The SBA application process has become more streamlined in recent years, but as products change assistance is still needed from SBA experts.

ERIC WEAVER

Founder and CEO

Opportunity Fund, San Jose, Calif.

Update the SBA microloan program to make it more responsive to lender practices and to increase utilization. Improve turnaround times on all SBA financing.

Use the power of the SBA to educate business owners about the opportunities and risks associated with various alternative financing options, including the responsible practices outlined in the Small Business Borrower's Bill of Rights.

RON SAMUELS

Vice chairman

Pinnacle Financial Partners, Nashville

Smaller banks like us who don't have the resources to run a full "preferred lender" shop typically wait a couple weeks for loan decisions or modifications to be made by SBA underwriters. The wait time directly affects small businesses.

Small businesses will see a boost if the administration lessens bank regulations because we would be able to approve loans more freely.

Todd Hollander

Managing director and head of business banking

MUFG Union Bank, Los Angeles

Revise Section 1071 of the Dodd-Frank Act, which is a measure detailing the information lenders must gather about applicants for commercial loans.

If Section 1071 is implemented as currently defined, the measure will create hard-to-manage and nebulous burdens for small businesses and lenders.

KEN KARELS

President and CEO

Great Western Bancorp, Sioux Falls, S.D.

Keep it simple. Streamline the process so it's not hard to do an SBA loan. Improve where you can and cut back on restrictive regulations. This goes for all regulatory agencies, not just the SBA.

Keith Mestrich

President and CEO

Amalgamated Bank, New York

We need to continue to bring to scale initiatives like Startup America, which provided incentives for the private sector to invest in businesses in low-income communities. When we provide businesses an opportunity to succeed, especially in underserved areas, we don't just change that business owner, we help to change a community.

BankThink

BY KAREN MILLS AND BRAYDEN McCARTHY

Fintech Charter Is Good For Small Businesses

Something transformational is taking place in the world of online lending. Over the last several years, new fintech competitors have challenged traditional banks with innovative, customer-friendly online applications and quick loan decisions. At first bankers saw these disruptors primarily as threats, grabbing share from community banks overburdened by regulatory compliance costs. The online players were said to have an advantage, with no federal regulator to oversee them.

This view has changed somewhat over time and will even more with the Office of the Comptroller of the Currency planning to provide oversight of fintech companies through a special-purpose charter. Some in the banking sector – who originally opposed the OCC idea as permission for "banking light" – now support the proposal. This is most likely due to banks' new strategy of partnering with the online entrants to take advantage of their technology. And to do so, they need their third-party partners to be compliant.

But besides the OCC charter, there is another regulatory need that should receive top priority – small-business borrower protections. If offering a national regulation option to fintech players is the proverbial carrot, compliance with commonsense borrower protections could be the stick.

These protections are important because credit extended for a commercial purpose is not covered by the disclosure requirements of the federal Truth in Lending Act. That means lenders, including traditional banks, can display loan terms and costs, such as annual percentage rates, inconsistently, which makes it difficult for borrowers to compare offers. Some bury prepayment penalties deep inside 3-inch-thick loan documents. Few disclose an APR at all.

The line of thinking that small-business owners are financially sophisticated or have knowledgeable advisers, has not proved to be the case, particularly for the large majority of those who take on small-dollar loans. A recent study conducted by the Federal Reserve Bank of Cleveland was telling. The research found that mom-and-pop businesses struggle to compare credit products when using information provided by alternative lenders on their websites.

Regulators should require disclosures that are clear and concise. If lenders had to compose standardized contracts in plain English – and provide APRs – it would go a long way toward reducing complexity, helping borrowers decide what is best for them, and eliminating bad actors.

Absent universal standards, it is considerably more challenging for lenders and brokers to take the high road when competing with irresponsible players. With that in mind, regulations could help those who are responsible lenders, so they aren't forced to choose between a race to the bottom on borrower protection and surrendering market share.

With regard to the OCC charter, some concerns also have been raised about financial inclusion. The argument that the fintech entrants should help foster small businesses in underserved communities has strong merit. We advocate that a program with goals similar to the Community Reinvestment Act be among the requirements for obtaining and maintaining the OCC charter.

OPINION

For more viewpoints on industry issues, visit the BankThink page on **AmericanBanker.com**

The OCC charter is a step in the right direction and holds the promise of promoting responsible financial innovation and improving small-business access to capital. Borrower protections and greater financial inclusion for small businesses would go even further toward accomplishing this goal. The charter, and the accompanying federal oversight, could become an opportunity to require additional transparency from new entrants and go after predatory behaviors.

Small businesses need a government that supports them – not just through lower taxes and less regulation, but also through smart and streamlined financial oversight that looks out for their interests. These types of actions will help the small businesses that drive our economy and form the backbone of our communities. And that should be a goal we can all agree on. □

Karen Mills, who served as head of the U.S. Small Business Administration from 2009 to 2013, is a senior fellow at the Harvard Business School. Brayden McCarthy is vice president of strategy for Fundera and a former senior policy adviser at the SBA.

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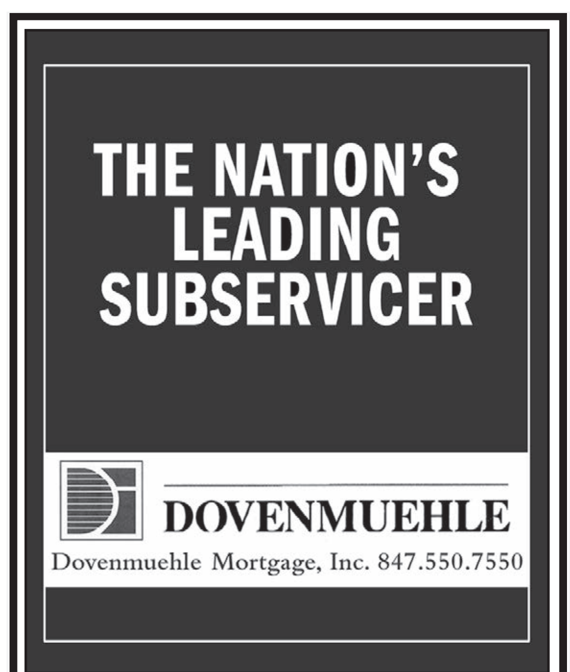

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BackPorch

CHRIS WHALEN

"This economy has gotten so conditioned to 2%and 3% mortgage rates that there is sticker shock."

Senior managing director at Kroll Bond Rating Agency, on the end of ultralow mortgage rates

NOAH BRESLOW

"I don't want to call it a shakeout yet, but I think we've seen some platforms start to raise the white flag."

OnDeck Capital's CEO, on the growing concern about credit performance at online small-business lenders

MICHAEL KRIMMINGER

"You can't expect bankers to be doing a social program."

Former FDIC official involved in the IndyMac deal, saying a very weak loan portfolio – not Steven Mnuchin – is to blame for the foreclosures at OneWest

GEORGE SOURI

"Mark my words: This is the beginning of the end."

LQD Business Finance's CEO, predicting the demise of online small-business lenders that rely on brokers, after CAN Capital reported credit trouble

PETER HENNING

"When your client base is large enough for the taxman to go on a fishing expedition to see who is using your services, you have truly come of age."

Law professor at Wayne State University, on the IRS demanding Coinbase turn over information related to bitcoin transactions

TED PETERS

"They clearly threw some holy water on it."

CEO of the Bluestone Financial Institutions hedge fund, saying regulators had to bless Republic First appointing the controversial Vernon Hill as its new chairman

JOE BIDEN

"We can't be lulled into a sense of collective amnesia."

Former vice president, defending the Obama administration's response to the financial crisis and urging Republicans to reconsider their opposition to the Dodd-Frank Act

BLYTHE MASTERS

"Distributed ledger technology is fashionable. In fact, if you could wear it, you'd put Ralph Lauren out of business, at least in my case."

Digital Asset Holdings' CEO, on all the blockchain hype

JARET SEIBERG

"This could have been far more consequential if Hillary Clinton had won the White House. Clinton said during a debate that she would demand that any bank that failed its living will submission be broken up."

Analyst with Cowen Washington Research Group, after regulators flunked Wells Fargo's resolution plan

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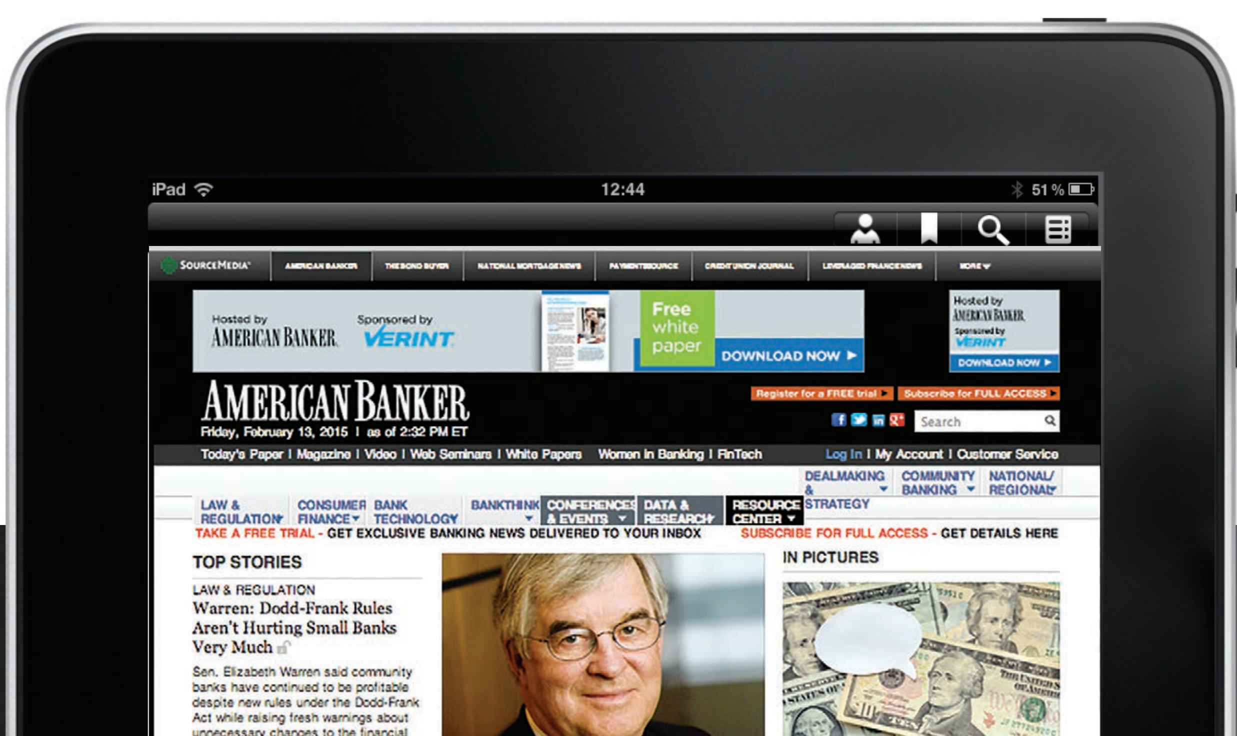

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