Adapting to the Digital Age: Community Bankers' View of Technology

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Blog 7 of 7: Community Bankers' View of Technology

By CSBS Chief Economist ***Thomas F. Siems****, Temple University Professor of Finance and CSBS Adjunct Research Scholar* ***Jonathan A. Scott*** *and Federal Reserve Bank of St. Louis Supervision Policy, Research and Analysis Manager* ***Meredith A. Covington***

Adapting to the Digital Age Series

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In this seven-part blog series, we explore how community banks are adapting to a changing digital landscape by analyzing banking and technology questions from the 2021 CSBS National Survey of Community Banks. Survey results are presented each fall at the annual Community Banking in the 21st Century Research and Policy Conference, sponsored by CSBS, the Federal Reserve and the Federal Deposit Insurance Corp.

In the seventh installment in this series, we share interview responses with community bankers from around the nation on their views about technology.

The previous six blogs in this series on Adapting to the Digital Age: Community Bankers' Perspective on Technology identified many key technology issues that community bankers have faced during the pandemic using responses included in the CSBS 2021

National Survey of Community Banks ("Survey"). Our main findings from this review are:

- Community banks are in a challenging economic environment characterized by declining loan demand, abundant liquidity and narrower net interest margins. (Blog 1)
- Community banks face competitive pressures from many directions: other banks, fintech companies, credit unions, government sponsored agencies and more. One possible path to counteract the economic and competitive pressures is through investments in technology. (Blog 2)
- Community banks' use of various technologies continues to increase. Community banks reporting the highest tech-usage tend to be larger (as measured by total assets), located in more populated areas, and appear to have greater economies of scale. (Blog 3)
- High tech-usage banks and larger banks view future technological innovation more as an opportunity than a threat. (Blog 4)
- For both external and in-house core service providers, community bankers were most satisfied with security, risk management and tech sophistication and least satisfied with innovation speed, cost, and contract flexibility. For many community banks, the ability to stay competitive requires both a responsive core service provider and the ability to improve efficiency and provide more revenue streams. (Blog 5)
- As community banks continue to consolidate, the CSBS Surveys find that mergers and acquisitions are being driven by a desire to increase economies of scale, a far more important reason than regulatory costs and succession issues. While fewer banks appear to be considering buy/sell offers, high tech-usage banks are more likely to offer to acquire another bank. (Blog 6)

From the CSBS Survey responses, it is straightforward to conclude that technology is important to future community bank success. Indeed, one of the final open-ended questions in the Survey asked respondents "What do you think the community banking industry will look like as the country emerges from the COVID-19 pandemic?" While the responses varied, the word cloud in Chart 1 shows there were some repeated themes that could be found within the responses. Most community bankers think the community bank industry will emerge stronger and with an expanded digital presence that builds on their relationship lending strategy. They also foresee more industry consolidation in a very competitive environment.

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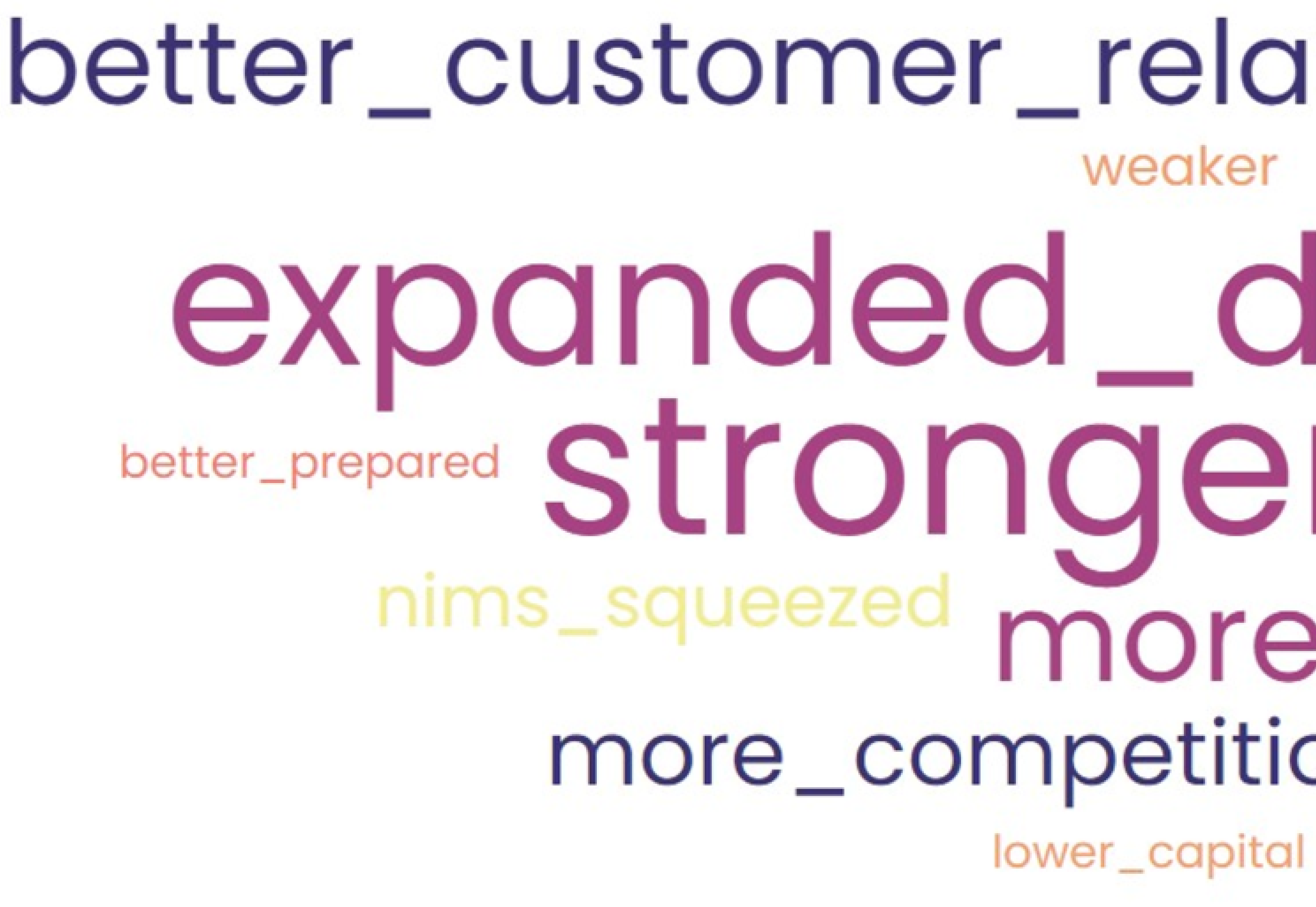
Word Cloud of Community B
“What Will Community Banks Look



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While many important insights were identified in the CSBS Surveys, many other important technology issues remain outside the scope of the survey. For example, what are the specific issues community bankers have with core service provider pricing and product development? What other ways are community banks interacting with fintech firms? And finally, what are community banks doing with the opportunity that tech is providing them?

To complement these responses, one of the authors confidentially interviewed a cross-section of community bank executives in the summer and fall of 2021. The interviews focused on the evolution of each bank's digital presence, what was going right and wrong with tech spending with a focus on core service providers, their experience with fintech firms as either vendors or Banking-as-a-Service, and their assessment of the headwinds and opportunities for tech investment and community banking. Over 30 community banks participated in the interviews from across the entire country with assets from under $200 million to just below $10 billion. The business models also varied by the emphasis on lending focus (e.g., Commercial Real Estate, Commercial & Industrial or 1-4 Residential).

The rate of technology adoption ranged from cautious late adopters to very fast followers. Despite the differences in tech strategy, the common thread was a core service processor. Many banks expressed frustration with the implementation times, ability to customize solutions, poor integration of core service processor acquisitions (e.g., lack of straight-through processing), and pricing for tech related services — reflecting the findings in the 2021 CSBS Survey. Many banks would like to implement third party solutions (often from fintech firms) but the pricing and cost to interface with their core system was often viewed to be prohibitive without sufficient scale.

Another common thread was the importance of a clearly defined strategy for tech implementation where the customer and business needs drive the technology choices and not vice versa. The pandemic changed customer behavior, which drove front-end demand for expanded person-to-person payment options, 24x7 ability to do business including online account opening, mobile or interactive teller machines. Demand increased for faster transaction times, including e-signatures for full electronic execution of all service-related documents. On the backend, many banks focused on improvement in work-flow processing to drive efficiencies by relying on or exploring tech investments.

The community banker view of fintech firms is more nuanced than simply "a disruptive competitor." Few bankers believed that either fintech firms or neo-banks were poaching their Commercial & Industrial and Commercial Real Estate business because of the size, complexity, and relationship-focus of their loan book. However, several bankers noted that improvements in data analytics, AI and machine learning could change their perspective on fintech/neo-bank competition for these loans. While all acknowledged potential competition on the deposit side from firms like Chime and other fintechs/neo-banks, no one was aware of any recent impact on their deposits.

Fintech firms were more likely to be either vendors for a community bank's digital infrastructure or a provider of Banking-as-a-Service. From the infrastructure side, fintech companies provide digital banking platforms (e.g., Q2), commercial loan management platforms, end-to-end lending systems and credit analytics solutions. Other applications include access to payments system, and business/personal loan products for high-risk or credit-impaired borrowers, business checking and wealth management. With the many opportunities associated with Banking-as-a-Service, there were also challenges, which included the designation of fintech deposits as brokered deposits subject to regulatory limits, the need to ensure that compliance and operating risk oversight is in place and the challenge of effectively managing multiple partners.

Looking ahead, community bankers noted several headwinds for their digital strategy. At the top of the list is the rate of increase in technology spending and the pricing of ancillary services to maintain or expand a bank's digital presence in the current macro environment. A close second is finding the right technology consistent with the overall business strategy and avoid being mesmerized by the next "shiny new thing." Third is the ability to execute, which included the ability to manage fintech partnerships, whether on the infrastructure side or Banking-as-a-Service and having the right talent to manage them. A notable omission from the list of headwinds was fintech/neo-bank competition for existing customers.

Despite these headwinds, community bankers see many opportunities to use their tech platform to withstand the increased competition in their markets. The key to success, as described by many bankers, is to clearly define their value proposition for their target market and then use their tech platform to support the strategy. While recognizing they cannot outspend their larger rivals, they can "out-relationship" them with a threshold level of digital assets in place to meet the needs of their customers. Others see multiple opportunities for fintech-supported infrastructure and Banking-as-a-Service to grow their banks and better serve their community. By participating as lending partners in private equity funds investing exclusively in banking related fintech or taking advantage of fintech initiatives by the state banking associations, bankers have several ways to identify these opportunities.

202.296.2840
newsroom@csbs.org
1129 20th Street, N.W., 9th Floor, Washington, DC 20036