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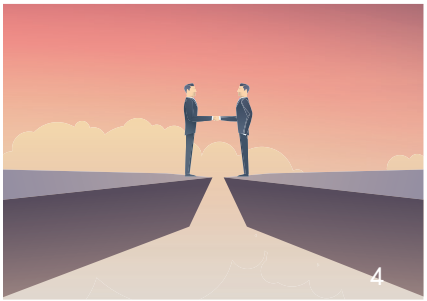


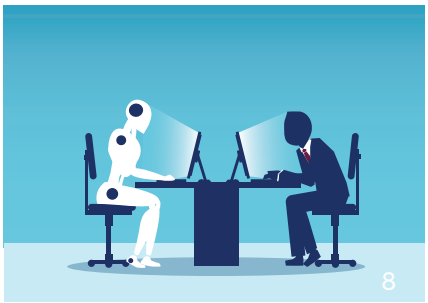


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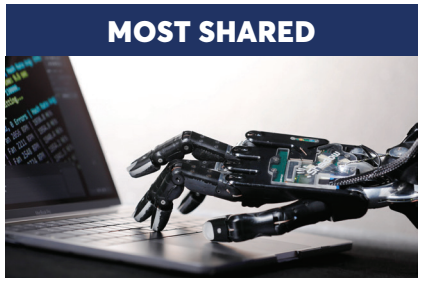
## MOST READ


### A Taker for Ripple's Digital Token

Despite controversy surrounding XRP, Ripple's digital token, one bank, Euro Exim Bank in London, is pushing forward to use it in cross-border payments. Several Euro Exim Bank clients are "almost desperate to make sure this can work," said Graham Bright, head of compliance and operations at the bank.

## MOST SHARED



Bloomberg

### 10 ways tech will change banking

2019 will bring a wave of data-sharing deals between banks and fintechs, increased bank use of automated advice, and much more. U.S. Bank, Wells Fargo, BBVA Compass and Banco Popular are among the banks with centers of excellence working to deploy robotics and artificial intelligence to streamline work processes.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# How Buying into M&A Could Pay Off

Consolidation of midsize firms in health care and other industries is expected to heat up. Regional banks offering M&A advisory services hope to capitalize on the trend.

**By Laura Alix**

Middle-market companies are increasingly open to selling themselves, and that is welcome news to banks with M&A advisory shops.

Regional banks have been gobbling up merger-and-acquisition advisory firms in recent years both to provide a broader array of services to corporate clients and capture the hefty fees that come from advising buyers, sellers or both.

Activity has been strong of late and M&A advisers say they expect it to pick up even more in 2019 as owners approach retirement age or look to divest units that are no longer core to operations.

"We see our fee income rising in M&A this year and I think it would be a healthy increase from a previous record year," said Ralph Della Ratta, head of M&A advisory for capital markets at Citizens Financial Group.

Della Ratta joined Citizens in May 2017, when the $160.5 billion-asset bank bought an M&A advisory firm, Western Reserve Partners, that he co-founded.

Several of Citizens' competitors, including PNC Financial Services Group in Pittsburgh, KeyCorp in Cleveland and Fifth Third Bancorp in Cincinnati, have recently acquired small M&A advisory firms as well.

In 2017, PNC bought Fortis Advisors, a San Diego-based shop that represents shareholders in private M&A deals, and Key acquired Cain Brothers, a boutique investment bank focused on the health care industry. Early last year, Fifth Third beefed up its own M&A services with its purchase of Coker Capital Advisors, a boutique firm that also serves the health care industry.

Those deals may be small, but bankers say they have been important for diversifying fee income, particularly at a time when some more reliable sources of fee income, such as mortgage banking, have leveled off or declined. Bankers also say that having an M&A advisory shop enhances their

overall commercial banking services and provides other cross-selling opportunities.

"There's an M&A fee to earn, but there's also private wealth, and there's financing [for the acquirer] and interest rate protection," said Terry Katon, head of capital markets at the $126 billion-asset Regions Financial in Birmingham, Ala. "That M&A advice can spin off into other business for us on either side of the transaction."

In 2015, Regions bought BlackArch Partners, a Charlotte, N.C., M&A advisory firm focused on middle-market companies.

For the $146 billion-asset Fifth Third, having an advisory arm means more opportunities for bankers to meet and network with decision-makers and experts in the fields the bank serves, said Bill Tyson, Fifth Third's head of M&A.

"This business is not just about earning the fee income associated with it, although that's nice," he said.

A recent survey of middle-market companies conducted by Citizens suggests there may be more demand for M&A services in the year ahead. The survey found that 62% are potential sellers — either actively looking to sell themselves in 2019 or agreeing they would be open to a deal if the right offer came along. In a similar survey last year, only 48% of respondents said they would consider selling.

The percentage of buyers who said they are shopping declined to 71% from 79% a year ago, a finding that Della Ratta attributes mostly to higher seller valuations. Still, he said he believes that companies' desire to grow or acquire new technology will motivate those companies to consider deals, despite higher asking prices.

Also promising for banks: 65% of potential sellers and 63% of potential buyers said they would prefer to work with an adviser on a deal.

Citizens defines middle-market companies as those with $50 million to $3 billion in annual revenue. The survey polled 601 executives at such firms.

Factors that could discourage dealmaking include increased acquisition costs stemming from rising interest rates, an economic slowdown or recession and the uncertainty surrounding the 2020 election. At the moment, though, many middle-market firms are motivated to make deals.

"We have a record pipeline going into 2019," said Fifth Third's Tyson. "We certainly recognize there are some exogenous factors that weigh a little bit on the overall market, but generally speaking, we have a cautiously positive outlook for M&A in 2019."

Banks do not typically break out M&A advisory income, but in fourth-quarter earnings announcements both Citizens and Fifth Third said that growth in advisory revenue helped offset declines in other fee areas, such as mortgage banking. At Fifth Third, for example, M&A advisory fees helped to boost corporate banking revenue 69% to $130 million, even as overall noninterest income remained flat. At Citizens, capital markets fees increased 7% to $45 million, thanks in part to a 56% increase in M&A fees.

On the buyers' side, the increased M&A activity has been driven in large part by companies' desire to increase their technology capabilities or find new revenue streams.

Among sellers, Citizens' Della Ratta said that many firms are run by baby boomers who are nearing retirement age and don't have children or grandchildren who are interested in running the business.

"The aging and graying of America certainly does contribute," he said. □

# Flip This Market

## Renovation lending gets a lift from fixer-upper TV shows

Popular TV shows about house fixers and flippers have sparked consumer interest in remodeling, creating an opportunity for lenders to build a specialty in renovation loans while traditional mortgage lending is weak.

Renovation refinancing offers lenders a great fallback plan as mortgage originations shrink and refinancing activity sputters. Remodeling activity has increased every quarter since 2015 and is expected to exceed $350 billion in the third and fourth quarters of 2019, according to the Joint Center for Housing Studies of Harvard University.

The rising popularity of HGTV remodeling shows could be a big contributor. Programs like "Fixer Upper," "Love It or List It" and "Property Brothers" averaged a combined weekly viewership above 8.6 million in 2017 and 2018, up from 5.8 million in 2014, according to Nielsen.

"They use the words 'renovation budget' in every single episode," said Vincent Nepolitan, national renovation sales manager at Planet Home Lending. "They're making people think, 'Hey, how do I do this? What can I do to change and remodel my home?' "

Even shows like "Fixer Upper," which ended its original run in 2018, often live on for much longer in reruns and on video streaming services. And the more Chip and Joanna Gaines enter people's living rooms, the more likely those homeowners are to seek out their own remodeling projects.

The shows are certainly good conversation pieces for lenders who want to promote the renovation loan,

which is an all-in-one transaction allowing homeowners to use the equity in their homes without taking out a second-lien mortgage. But the product is largely unknown and requires some consumer education.

Television personality Ty Pennington, best known for "Extreme Makeover: Home Edition," has been a pitchman for Guaranteed Rate since 2013. The Chicago-based nonbank mortgage lender has used him in numerous ad campaigns that appear during home renovation shows.

"Who doesn't want to own their dream home? That's why these shows are so popular," said Tim Floyd, renovation manager at Guaranteed Rate.

A lack of knowledge about this type of loan is the biggest hurdle to growth, he said. "Renovation refinancing is underutilized because there aren't a lot of consumers who know what you can do with renovation loans," said Floyd. "Overall, I think it's going to continue to increase to one of its bigger years, just based on the lack of inventory available and the age of housing. It's just a matter of the information getting to the consumers."

Renovation refinance is considered rate-and-term, allowing the highest combined-loan-to-value ratios, or CLTVs.

Cash-outs permit a maximum CLTV of 85% based on existing property value. Renovation loans use after-completion value and — depending on the program — bump the CLTV to 95% or 97.5%.

The loan is especially advantageous for homeowners without a lot of equity, particularly those who purchased a house in the last year with Federal Housing Administration financing or with a lower down payment. The renovation loan's use of as-completed value gives the borrower more opportunity to make needed improvements without the pain of pulling cash out.

"There are a lot of myths out there that the refi market is dead and dried up and the rate environment is making things harder," Nepolitan said. "Look into the programs and the options out there. What people don't realize about the renovation loan is the scope of financing. FHA, conventional, VA — it doesn't matter what program it is, they all have a renovation channel."

Price could be an obstacle in some cases. "Renovation loans typically have higher pricing in general compared to nonrenovation counterparts," Floyd said. "The rates are higher because companies need to have their own internal draw departments."

But, he added, the value borrowers receive compensates for the extra cost.

A spike upward in renovation refinancing could help lenders avoid having to sell their businesses or having to merge with other companies at an otherwise tough time in the mortgage sector.

The appetite for remodeling is expected to remain strong. "Baby boomers said they intend to age in place. As you get older, it requires some accommodations, things like door handles, potential wheelchair ramps, bars in the shower, that type of thing," said Doug Duncan, chief economist at Fannie Mae.

Generation X also is expected to be doing remodeling. "Say Gen Xers maybe have kids in junior high or high school and would like to move up. But there simply isn't inventory, and it's expensive if they're in an urban center and in a school district they like. They simply say, 'We own the land, we own the first floor, why don't we tear the roof off and build a second floor?' That way they aren't dislocating the family," Duncan said.

The boomer generation is one of the reasons that the supply of existing homes is at 30-year lows relative to demographics. Despite recent year-over-year gains, inventory is limited, especially in the case of affordable homes. While this inhibits first-time homebuyers, those who have outgrown their current house have the option of building up or out. — *Paul Centopani*

# Small-Dollar Balancing Act

## FDIC effort to ease restrictions worries consumer groups

Scores of consumer groups, state authorities and others are urging the Federal Deposit Insurance Corp. to maintain controls on small-dollar loans if the agency proceeds with a plan to enable banks to compete with payday lenders.

The FDIC's request for input, published in November, on how to regulate small-dollar lending drew myriad opinions from commenters calling on the agency to support interest rate caps and restrict banks' use of nonbank partners to develop loan products. State officials, meanwhile, defended their authority to enforce consumer protection laws.

"State regulators oppose any federal agency action that fails to respect the ability of states to control interest rates and impose additional consumer protections for small-dollar credit products," John Ryan, president and chief executive of the Conference of State Bank Supervisors, said in a letter to the FDIC.

The agency is exploring how to reopen small-dollar lending options for banks, which have complained that tighter regulation in recent years has

made it nearly impossible for them to enter the business and therefore pushed consumers to seek nonbank options. In 2013, guidance issued by the FDIC and the Office of the Comptroller of the Currency effectively banned banks from offering deposit advance products.

In interviews and among the more than 60 comments submitted to the agency, a key area of contention is how to make small-dollar loans affordable for consumers yet profitable for banks at interest rates that don't exceed various state caps.

Consumer groups are urging the FDIC to retain the deposit advance guidance; the OCC rescinded its guidance in 2017. Commenters also want the FDIC to impose a 36% cap on annual percentage rates for banks' small-dollar lending. The agency encouraged institutions to stay under that APR limit in a 2007 guidance on "affordable small-dollar loan products," and a 36% cap is used in federal law restricting the terms in credit products sold to military service members.

"The FDIC should maintain their long-standing guidance that small-dollar loans should be at 36% or less," said Lauren Saunders, associate director of the National Consumer Law Center. "Loans above that rate really risk being unaffordable for consumers and lead to practices where lenders can become more predatory."

After the OCC's rescission of its deposit advance ban, the agency released a bulletin this past May authorizing national banks to compete with payday lenders. The bulletin encouraged banks to make small-dollar installment loans of 45 days or more to borrowers with FICO scores of 680 or below.

Industry groups are hoping the OCC and FDIC ultimately follow the same path on a small-dollar lending policy.

Currently, with the two separate tracks, "it creates uncertainty and even if a bank is not regulated by one of those agencies, they still take that to heart and for their reputation," said Richard Hunt, president and CEO of the Consumer Bankers Association. "It's better that all the regulators are on the same page."

But the FDIC has been more cautious, instead choosing to follow a longer process and field comments before taking any action, which many consumer groups see as a positive sign.

Many lenders say interest rate caps and other restrictions were a big reason they left the small-dollar business.

"While we understand that Annual Percentage Rate ... is the universally accepted standard in the industry for measuring the cost of credit, it can be argued that APR does not fairly measure the cost of convenience that a consumer is willing to pay for a small dollar loan," wrote Rajive Chadha, head of consumer products and origination partnerships at Regions Financial.

The Alabama bank had offered a deposit-advance product called Ready Advance in 2011, but got out in 2013.

"Further, an APR calculation is difficult to perform on an open-end line of credit, such as Regions' prior Ready Advance product," Chadha said. "Focusing on the APR also loses sight of the fact that these types of loans, including Regions' product, are less costly than small dollar loans from other sources such as payday lenders."

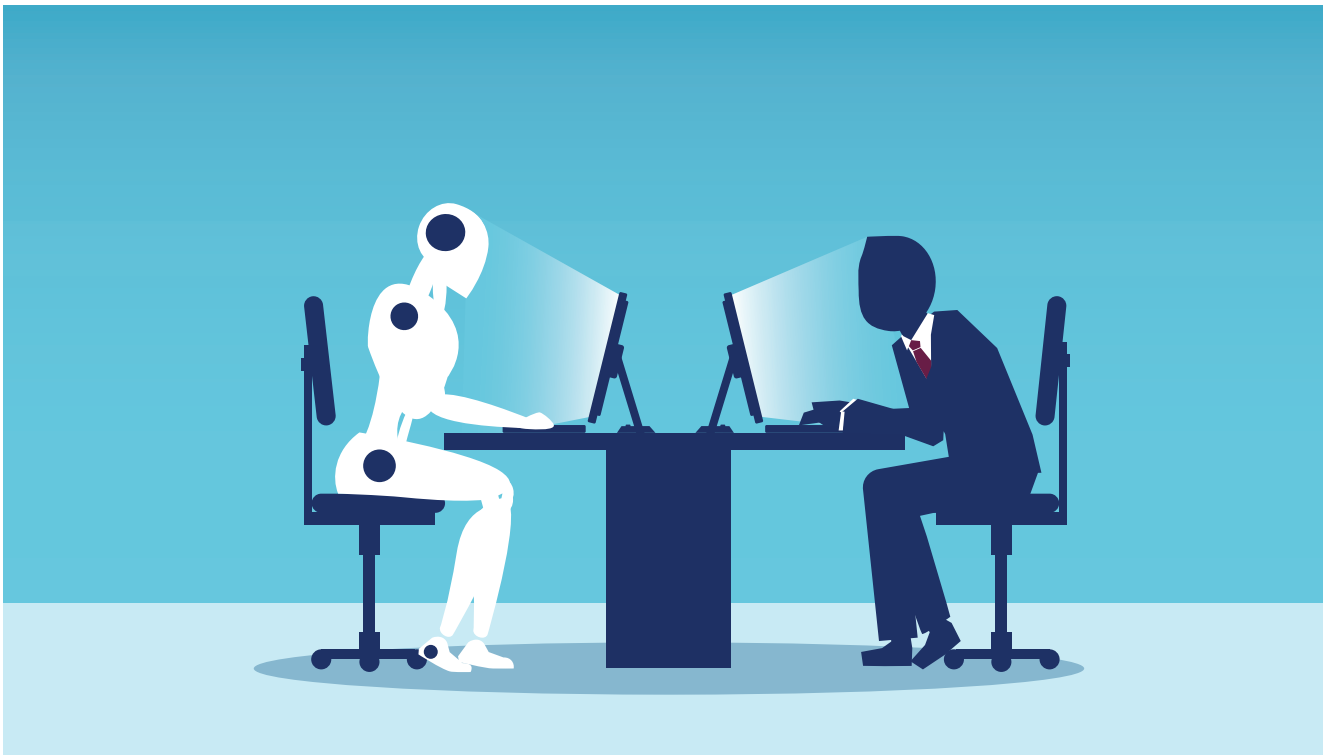
Former FDIC chair Sheila Bair also wrote to the agency, suggesting it keep the 36% interest rate cap with some flexibility for smaller loans in order to make it a viable option for banks. Bair ran the FDIC when it released the 2007 guidance and completed a small-dollar loan pilot project in 2008.

"Larger, longer term loans have flourished using the 36% target rate contained in the FDIC guidance," she wrote. "However, rates above 36% may be necessary for loans of just a few hundred dollars to stimulate more competition, even though unnecessary for loans of a few thousand dollars."

Bair also advised the FDIC to permit banks to streamline underwriting, such as with the use of alternative credit data and third-party service providers. "Service providers to banks offer ready-to-use turnkey platforms that can process an application, underwrite a loan, and deposit funds into the borrower's account, all within a few minutes," Bair wrote. "One benefit of banks' lending to their own customers using new technology is that they can be faster than payday lenders, as they have a better knowledge and understanding of their borrowers through their pre-existing relationships."

Some nonbank lenders and fintech firms also suggested that the FDIC should clarify its policy on bank partnerships, including that the interest rate originally set by the underwriting bank stay the same for the life of the loan, regardless of whether it is sold. This practice, known as the "valid when made" doctrine, has been challenged by a 2015 court ruling and is heavily opposed by state regulators.

"To ensure safety and soundness, it is crucial that small loans can be sold into the broad credit market with loan contracts remaining enforceable on their original terms," wrote the Marketplace Lending Association, which set a 36% APR cap for its members. "Indeed, the valid-when-made doctrine is critical to a healthy financial system, small businesses, and consumers because it ensures liquidity in the credit markets, thereby reducing the cost of credit to borrowers." — *Rachel Witkowski*



# New tactics detect elder abuse early

Some banks are using artificial intelligence to flag suspicious activity in the accounts of elderly customers, including scams hatched by family members

By Penny Crosman

Banks are stepping up their efforts to combat financial elder abuse, and artificial intelligence software could become part of the solution.

With the number of cases on the rise, banks big and small are actively looking to use AI to flag suspicious activity in the accounts of elderly customers. Some big banks, including Wells Fargo, have internal initiatives underway, while many smaller banks are working with tech vendors to tackle this type of financial crime.

"Wells Fargo has been focusing on this as an issue and building analytics for it, very much like we do for other things like fraud," said Rich Baich, the chief information security officer for the San Francisco banking giant.

Baich said teams of data scientists are creating proprietary models intended to help the bank detect elder abuse, with the goal of deterring it.

"We're greatly concerned, and we're putting time and resources behind it," he said.

In 2018, U.S. banks reported 24,454 suspected cases of financial elder abuse, a 12% increase over 2017, according to the Financial Crimes Enforcement Network, which is a unit of the Treasury Department.

But elder abuse often goes unreported. Banks do not have to include exploitation of the elderly on suspicious activity reports unless a certain threshold is met.

"The problem is, no one is mandated to do it, and if they're not mandated to do it, no one is going to do it because there could be negative ramifications," said Larry Santucci, senior industry specialist at the Federal Reserve Bank of Philadelphia.

"For example, you don't want to be the only one reporting on your elder exploitation cases. Banks and financial advisers are in a difficult position. Even

the ones that want to help can't muster the fortitude to share this kind of data and report it."

Banks should be allowed to share this kind of information with each other, Santucci said.

## Cases 'every week'

Bank executives and industry observers say that this type of fraud is growing rapidly, even more so than the official numbers suggest.

Laurel Sykes, senior vice president and chief risk officer of Montecito Bank & Trust, started to notice an increase in different types of elder scams in 2015 and built a department to deal with such crimes.

"We used to see a handful of cases a year — now we see a handful of cases every week," Sykes said. The majority of the bank's customers are baby boomers and older.

"We see the grandparent scams, and we're seeing more of the romance scam," Sykes said. "Our older customers are either divorced or widowed, and they're out on dating websites being scammed by people pretending to be someone else."

Her bank also sees work-at-home scams, where customers who think they are hired for a job receive a check that turns out to be bogus.

Moreover, it has come across grandsons, daughters and other family members who are supposed to be taking care of the older person but are actually stealing from them.

In one case this month, the bank suspected a daughter-in-law of taking a client's money. The bank filed its suspicions with adult protective services.

"The son- and daughter-in-law kidnapped our client, took her out of the state and ran off with her money," Sykes said. "But because we'd done our filing, law enforcement was able to step in, and they got caught."

Judy Long, president and chief operating officer of First Citizens National Bank in Tennessee, said her bank filed more SARs for elder financial exploitation in 2018 than ever before.

Some of her customers have been told they have won a lottery ticket and then get asked to provide their account information to receive the payment. Others have been scammed by family members.

Research shows that elder scams are usually perpetrated by loved ones and caregivers, according to Liz Loewy, former chief of the elder abuse unit in the Manhattan District Attorney's Office and current co-founder and COO of EverSafe, a provider of software for detecting senior scams.

Santucci pointed out that the over-65 population in the U.S. grows by 10,000 every day, so even if only 3% are affected by elder financial exploitation, the numbers will continue to grow.

## Tech approaches today

In addition to educating branch staff and customers about the signs of elder abuse, many banks use existing fraud detection, anti-money-laundering or Bank Secrecy Act compliance software to detect suspicious behavior.

Such programs are typically rules based. A rule might be, if a debit cardholder is over 70 years old, and the card is used for three or more transactions between midnight and 3 a.m., flag that account for potential fraud.

Montecito Bank uses the BSA software from Verafin to analyze the accounts of clients over 65. It tracks if an account balance is decreasing, and if that jibes with past activity. It analyzes account access to see if new individuals have been approved to use the customer's account. It looks for transaction types uncommon to that customer, such as suddenly wiring money out of the account.

The bank's information technology department also is working on a way to detect scams in which seniors are talked into buying gift cards and phoning in the numbers on the back.

Last year, Long at First Citizens combined the bank's fraud and BSA departments and deployed a transaction-monitoring system to track the accounts of customers over 65, looking for patterns of fraudulent activity. "We know our monitoring tools are catching that early so we can set up visits and conversations with those customers to find out how it started, why it started, and hopefully begin to prevent that," she said.

## Need for AI

Rules-based transaction monitoring software can see what happened, but cannot predict what is likely to happen.

"The big problem with transaction monitoring is it typically relies on a big drop in balances before the alerts go off," Sykes said. "We'd love to get out in front of it before the balances have dropped."

What is needed, Santucci argued, are programs that can compute the probability that a person will be involved in a fraudulent scam or financially exploited.

He cited EverSafe as one example of AI-based software that can detect "diminished financial capacity, a loss of executive function that prevents you from performing your day-to-day banking tasks."

Before an older person becomes susceptible to elder fraud, such as a grandparent scam, their banking behavior often becomes erratic, he said.

"Your banking transactions go all

over the place," Santucci said. "You're forgetting to pay bills, you're forgetting your password, you're making mistakes in your banking that you then cover up by bringing in money from other accounts."

Banks can analyze such behavior to build predictive models to determine the likelihood that an older customer will be defrauded or financially exploited.

"You need to do predictive analysis to save people money before the money goes out the door," Santucci said. "The technology is there to get in front of it."

EverSafe uses predictive models to build a profile of each senior banking customer's behavior. Then the software looks for deviations from that profile.

The software sends alerts out to the senior and trusted advocates — family members, financial advisers, lawyer and accountant. An alert might flag the absence of a pension check that is normally deposited at a certain time each month, for instance.

"That transparency can be a deterrent in and of itself," said Howard Tischler, co-founder and chief executive of EverSafe.

Tischler started EverSafe after his mother was scammed. A telemarketer sold her an auto club policy when she did not have a car or a driver's license and she was legally blind. Then other telemarketers sold her inappropriate things, and she stopped paying her long-term-care insurance, withdrew money early from her annuities, and had a friend who was helping her write bills who would write checks to herself.

"She lost her lifetime of savings as a result," he said.

One advantage EverSafe has over banks' internal efforts, according to Tischler, is that it can analyze transaction behavior across accounts at multiple banks and investment advisers. "The fact of the matter is that this stuff happens across accounts," he said.

Fidelity and Raymond James are both EverSafe clients; some banks also use it but will not talk about it publicly, Tischler said.

Wells Fargo uses its own machine-learning models.

"We have a team of dedicated data scientists who build model-based, machine-learning capabilities to identify anomalous and suspicious patterns to protect our clients," said Ron Long, director of elder client initiatives for Wells Fargo Advisors. "We continue to refine our approach over time by adding new sources of information, both structured and unstructured data, to strengthen detection and prediction of potential concerns."

Machine learning is required to analyze the hundreds of thousands of transactions Wells Fargo processes daily and find the 400 or 4,000 that require a closer look, he said.

"While a tool can't replace human assessment, machine-learning capabilities play an important part in our strategy to reduce the number of matters requiring a closer look so we can focus on actual cases of financial abuse," said Ron Long, who is unrelated to Judy Long. "This is what the industry needs and what we are continuously striving towards."

Judy Long said First Citizens recently began experimenting with AI software that mines debit card and online banking data to detect fraud.

"We would like even better software to help us solve these cases and pinpoint elder fraud even faster," she said. "On digital channels, fraud can happen so quickly. If fraud patterns could be detected quicker, we would like that."

# Bragging Rights

## Online lender Marlette, in the black, tweaks rivals in the red and hints at new loan products

Marlette Funding, which offers personal loans under the Best Egg brand, resembles many other online consumer lenders, except for one characteristic: It reports steady profits.

The Wilmington, Del., company said its net income was positive in the fourth quarter, as it has been since the second quarter of 2017.

Its chief executive, Jeffrey Meiler, used the occasion to take some jabs at the competition — both more recognizable online lending startups like Prosper Marketplace and traditional banks like Goldman Sachs.

Unlikely publicly traded firms, the privately owned Marlette is not required to share its quarterly results, and the few bits of information that the company released do not offer anything close to a full picture of its financial performance.

Marlette was vague about just how much money it earned during the quarter, saying that its net income, calculated using generally accepted accounting principles, was in the double-digit millions.

It also said that its profitability was 79% higher than in the year-earlier period.

But, in an interview, Meiler drew a contrast between his company's recent track record and that of other online lenders that specialize in the consolidation of consumer credit card debt.

Meiler noted that Prosper has lost a total of $135 million in the last six quarters that it has reported results. He also pointed out that LendingClub has lost nearly $240 million over the same

span.

Marlette, which began in March 2014, has facilitated loans totaling more than $7 billion over the last five years. Its loans are similar to those from competitors: They range from $2,000 to $35,000, and carry annual percentage rates of between 5.99% and 29.99%.

Meiler said that borrowers have been repaying his company's loans at a consistent level, which has enabled Marlette to borrow funds at comparatively low rates.

He pointed to relatively low expenses as another reason that the company is profitable, saying that Marlette has workers in Buffalo, N.Y., and St. Joseph, Mo., while competitors are in much pricier downtown San Francisco.

Spokespeople for LendingClub and Prosper, both of which are based in San Francisco, declined to comment.

LendingClub announced in November that it plans to open a new office in Salt Lake City, part of an effort to improve the company's operating efficiency. Prosper has an office in Phoenix.

Before founding Marlette, Meiler was a U.S. credit card executive at Barclays, where he worked with several of his current colleagues.

In the interview, Meiler pooh-poohed the efforts of some banks to compete in the booming personal loan business. "The startup mentality you get because it's do or die. It's your own money at play," he said.

He also took a jab at Goldman Sachs for its declaration in May that it has invested $600 million in Marcus, its 2-year-old consumer banking unit, including both capital spending and operating losses.

"My perspective was, you shouldn't be bragging about that," Meiler said. "That's a lot of money."

A Goldman spokesman declined to comment.

In a January report, analysts at S&P Global Ratings wrote that the credit cycle is incrementally closer to a turn in 2019, and they flagged personal loans as one key area of concern with respect to credit performance.

Meiler acknowledged that the credit cycle is in its later stages, but he said that Marlette's approach to underwriting loans was built to withstand recessions. He also said that the company plans to roll out new loan products this year, though he declined to provide details.

Marlette's loan volume increased by 27% year over year in the fourth quarter, and it plans to continue expanding lending in 2019.

"We don't see anything in our performance that concerns us," Meiler said. — *Kevin Wack*

# Healthy Growth

## GreenSky designs new loan for medical provider niche and expects to scale up rapidly

GreenSky, which partners with doctors, dentists and other health care providers to offer financing to consumers, has added a new way for repeat borrowers to pay.

The Atlanta fintech launched a revolving credit line of up to $25,000 in late January. GreenSky previously offered only installment loans.

The new product is designed to be a better fit for elective medical providers that rely heavily on repeat business.

For example, dog owners who bring their pets to the same veterinarian on a frequent basis would only have to apply for credit once.

GreenSky, which went public last year, derives the bulk of its revenue from loans made in partnership with home improvement merchants. But the division of the company that focuses on financing for health care procedures has been growing quickly.

GreenSky had 2,384 partnerships with elective health care providers in the third quarter of last year, up from just 155 in the first quarter of 2017, according to a recent presentation.

"Our growth trajectory in elective health care transaction volume continued to mirror what we saw early on in our home improvement business," GreenSky's founder and chief executive, David Zalik, said during an earnings call in November.

In a January interview, another GreenSky executive said that over time he expects revolving lines of credit to become a larger part of the company's health care business than installment loans. "We'll be scaling in a big way throughout 2019," said Dennis Kelly, the president of GreenSky Patient Solutions.

Health care providers that use GreenSky's revolving credit line can customize the terms that they offer to their customers, Kelly said.

One of their options is deferred interest, in which borrowers owe no interest as long as they pay off the principal balance before the promotional period ends.

In other situations, customers can be charged annual percentage rates of up to 29.99%.

GreenSky is not a direct lender but rather a facilitator of loans made through its bank partners. It plans to pass the credit risk associated with the new financing product on to banks, which is how it operates its installment loan business.

GreenSky's bank partners include Regions Financial, Fifth Third Bancorp, BMO Harris Bank, Synovus Financial and Flagstar Bank. — *Kevin Wack*

# Have Bank Profits Peaked?

## The answer depends on who you ask, but an analysis of deposit and loan trends offers some insight

Higher interest rates helped boost the bottom line for banks last year, but many investors are skeptical about whether the growth streak can continue.

"It's the million-dollar question," said Sandler O'Neill analyst Alexander Twerdahl.

Ultimately the answer will vary, depending on which bank you're asking.

But recent earnings trends at banks that trade on the three major exchanges offered hopeful signs for the industry overall.

Against a backdrop of rate hikes, many banks continued to contain deposit costs while benefiting from higher yields on both loans and investment securities.

On a year-over-year basis, fourth-quarter earnings per share rose a median of 25.7% for the 346 publicly traded banks that had reported earnings through Feb. 1, according to Sandler O'Neill.

But a linked-quarter comparison may be a better measure, as the federal corporate income tax cut in December 2017 skews the year-over-year comparisons. For the same group of banks, EPS rose a median of 0.7% in the fourth quarter, compared with the previous quarter. Twerdahl had projected EPS to fall by the same percentage rate.

Many investors and bankers have said this profit growth could be nearing its end. They argue that banks have held back as long as possible on raising deposit prices.

Retail customers are starting to realize that they can shop around for higher rates on savings accounts, Tom Broughton, chief executive of the $8 billion-asset ServisFirst Bancshares in Birmingham, Ala., said in a Jan. 22 conference call.

"They've been asleep and now they're starting to wake up, just like the corporate borrowers have," Broughton said.

The cost of deposits rose a median of 33 basis points in the fourth quarter, on a year-over-year basis, for the group of 346 banks. The cost of funds, which includes liquidity sources like Federal Home Loan Bank advances, increased a median of 37 basis points.

But whether this signals the end of the industry's profit growth is an open question. For smaller banks, that might be the case, Twerdahl said.

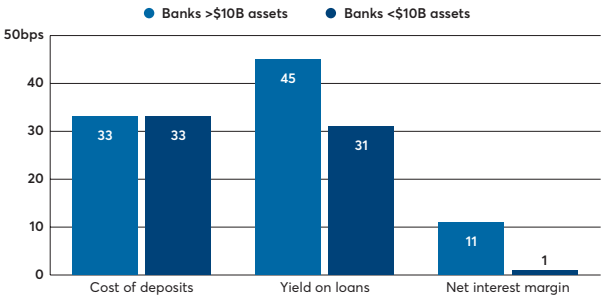
They have to pay deposit rates above market averages as a way to overcome the advantage big banks have with their massive retail networks, he said.

The big banks may still have some runway for profits to go higher, because "they've got more pricing power and more variable-rate loans," he said.

Indeed, net interest margin improvement has lagged at smaller banks. For the 92 banks over $10 billion of assets that had reported earnings through Feb. 1, the median year-over-year growth in NIM was 11 basis points, according to Sandler O'Neill. For the 254 banks smaller than $10 billion in assets, the median NIM improvement was only 1 basis point.

**Bigger Is Better**

Larger banks may be able to use their scale to grow their profits faster than smaller banks, even as deposit costs rise. Data shows year-ver-year increases, measured in basis points




Source: Sandler O'Neill

Some argue that loan growth will be the key metric to watch. In the fourth quarter, net loans rose a median of 8.2% from a year earlier, on an annualized basis, for the group of 346 banks.

Twerdahl said median loan growth has been positive for banks of all sizes across all geographies.

The flip side is that led to higher loan-to-deposit ratios. At the banks with more than $10 billion of assets, that ratio rose a median of 71 basis points in the fourth quarter, compared with a year earlier, to 91.38%. For the smaller banks, the increase was a median of 54 basis points, to 94.77%.

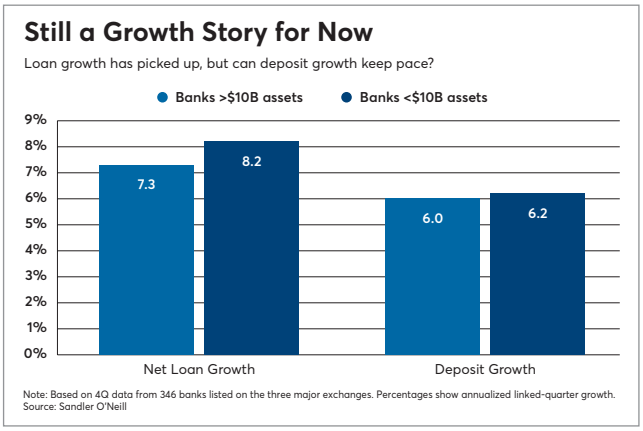
But some bankers are optimistic about the profit poten-

tial even if loan growth does not continue.

"I think we've got a shot at moving margins up," Johnny Allison, chairman of the $15.3 billion-asset Home BancShares in Conway, Ark., said during a Jan. 17 conference call.

Allison said that's mainly because he expects loan rates to continue trending higher.

"Hopefully we can get better on the cost of funds side," he said. "If we can do that, I think we can increase the spreads and, with or without loan growth, I think we're going to make more money."




Chris Marinac, an analyst at FIG Partners, offered a similar optimistic outlook in a Jan. 28 research note, where he compared earnings trends at banks in four separate asset size groupings.

All four groups — $500 million to $1 billion in assets; $1 billion to $10 billion; $10 billion to $50 billion; and those above $50 billion — reported revenue growth. "This is a sign of strength for the banking industry," Marinac wrote.

Moreover, in his analysis, 60% of the banks that had reported earnings at that point were beating their pretax, pre-provision returns on assets from a year earlier and about half were improved from the third quarter. Marinac used pretax, pre-provision returns on assets as a measurement because it eliminates the impact of taxes.

Those are all signs that augur well for the future, Marinac said.

"Who says profit has peaked at banks?" he asked.

*— Andy Peters*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"Privacy will have a **red-hot focus** in the

# Privacy Debate

"There's the old saying, if you're not at the table, **you're on the table.**"

"It is very likely that **the states will step up** and create

second half of this year."

"Equifax changed everything from an awareness perspective for **policymakers."**

# Are banks ready?

By Victoria Finkle

"Tech is replacing banks as the bogeyman – but banks do need to be fearful of **collateral damage."**

more of a patchwork around privacy security."

September 2017 was the beginning of the end.

That's when Equifax disclosed publicly, for the first time, that nearly 150 million people had their personal information — including names, addresses and Social Security numbers— stolen from its database.

Major data breaches at retailers such as Target and Home Depot had gotten a lot of attention from the media and consumers. But the hack at the credit bureau would touch the financial services industry in a way that earlier incidents did not. It also would help spur a broader national conversation around privacy that continues to gain momentum, both at the state level and on Capitol Hill.

"When Equifax got breached I thought, 'Uh-oh, the barbarians are at the gate,' " said Camden Fine, president and chief executive of the bank consultancy Calvert Advisors and former longtime head of a community banking trade group. "Equifax and the other credit rating agencies are core to so many lending decisions that I knew the banking industry was going to become fully engaged in the privacy debate."

And there was still more to come. Facebook's scandal in March 2018 — when the political consulting firm Cambridge Analytica, hired by the Trump campaign, gained access to data for 87 million social media users — shocked the public. CEO Mark Zuckerberg's poor performance before Congress a month later riled the critics even more.

"Equifax changed everything from an awareness perspective for policymakers, but a response takes time to catalyze," said Sam Taussig, head of global policy at Kabbage. "Cambridge Analytica really caught policymakers' attention and motivated folks to think about actual reforms."

At the same time, Europe has been developing its own, much stricter privacy regime, known as the General Data Protection Regulation, or GDPR, which went into effect last spring, with far-reaching consequences for U.S. businesses that operate overseas, including financial services companies.

California has led the way stateside, with the passage of a sweeping new consumer privacy law last summer.

While banks have often been on the sidelines of political discussions surrounding privacy and security, the industry is hardly immune. Even in California, where the new privacy law includes some carve-outs for banks, the compliance burden could prove extensive. The law, which applies to all companies that collect data on California residents, goes into effect in January 2020.

"It'll be a costly process — there's a lot of groundwork to be laid," said Crystal Sumner, head of legal and compliance at Blend, a San Francisco company with a namesake software platform for consumer lending.

And California is just the first to act. Banks may find they have new requirements to meet elsewhere soon. New York and Washington are among the states with bills on privacy and data security pending, and other states have approved related legislation in recent years, including Colorado, New Jersey and Vermont.

At the same time, Congress has been looking into its own reforms, and even if divided attention has stymied progress in the past, some observers believe the topic is going to have sticking power this year.

The presidential election now gearing up could provide an especially bright spotlight for privacy proposals.

To avoid the worst of the blowback, the financial services industry needs to play an active role in the debate on Capitol Hill and around the country, analysts argue.

"Tech is replacing banks as the bogeyman — but banks do need to be fearful of collateral damage," said Edward Mills, a policy analyst at FBR Capital.

Banks also need to start preparing for potential changes ahead — regardless of whether they serve customers in California. Overhauling systems and procedures is no small task.

For now, there are at least three key questions facing the industry.

## How high are the stakes for banks?

It's clear that the issue of privacy isn't going away anytime soon.

Large tech firms and others with the least oversight in place right now are likely to endure the brunt of any new rules, whether in Congress or at the state level.

Even so, financial institutions can't avoid the debate, and it's not in their best interest to try. Engaging is the only way to shape the outcome.

"Privacy will have a red-hot focus in the second half of this year," said Kabbage's Taussig.

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# Who's Who in the Privacy Debate

A snapshot of some of the key players and proposals, both on Capitol Hill and in state capitals around the country

## Federal

### SEN. MARCO RUBIO, R-FLA.

- Introduced legislation in January that would direct the Federal Trade Commission, or FTC, to draft new consumer privacy restrictions that would then have to be approved by Congress

### SEN. BRIAN SCHATZ, D-HAWAII

- Sponsored a bill in December 2018, backed by more than a dozen Democratic colleagues, that would require companies to safeguard personal consumer data online and prohibit them from using the information in ways that would be harmful to consumers

### SEN. RON WYDEN, D-ORE.

- Released draft legislation in November 2018 that would give the FTC more power to punish companies for privacy violations, require companies to submit an annual privacy protection report and mandate the creation of a national website that would allow consumers to opt out of data sharing online

### SEN. JOHN THUNE, R-S.D.

- The chairman of the Commerce Committee said last fall that he plans to pursue legislation on this issue. "We're trying to take some of the best ideas out there" and "incorporate them into a legislative package," he told Politico in September

### SEN. MARK WARNER, D-VA.

- Warner's office published a white paper over the summer outlining steps that could be taken to regulate social media and tech companies. The paper suggests creating legislation similar to Europe's strict privacy policy, the General Data Protection Regulation, or GDPR

### HOUSE LAWMAKERS

- Reps. Hank Johnson, D.-Ga., and Marsha Blackburn, R.-Tenn., are among those who introduced privacy-related bills last term

In arguing that they should not be treated in the same way as other types of privacy gatekeepers, financial institutions are expected to emphasize their requirements under the Gramm-Leach-Bliley Act, or GLBA. This law, which has been in force for nearly two decades, mandates that customers receive an annual privacy notice, with few exceptions, and significantly restricts the kind of information that can be shared with third parties. It also requires employing "reasonable" security standards to protect customer information.

"We're looking to prevent any additional burdens being put on the banking sector, which already abides by very strict guidelines of protecting people's privacy," said Paul Merski, group executive vice president for congressional relations and strategy at the Independent Community Bankers of America.

Count California as a victory on that front. As state officials passed the new law there this summer, they ultimately added clarifying language around a GLBA carve-out for banks. While not an exemption from every facet of the new law, the carve-out will mitigate the overall compliance effort.

"Banks are trying to figure out exactly how GLBA applies — it's not super clear what's in and what's out," Taussig said. "That's top of mind among banking attorneys and the California attorney general right now."

As the debate heats up across the country, consumer advocates will be pushing for tougher new rules to ensure data privacy and security is protected.

"We want to make sure that everybody has the strongest data security and data breach provisions and we also don't want companies sharing information promiscuously," said Ed Mierzwinski, senior director of the federal consumer program at U.S. Public Interest Research Group, or PIRG.

In addition to industry-specific exemptions, like a GLBA carve-out, Mierzwinski said that the business community will be looking to Congress to preempt stricter state laws as part of national legislation — something that he warns consumer groups will vigorously oppose.

At the same time, any new reforms — at the state or national level — that affect the financial services industry will quickly bring layers of nuance to the debate.

For example, updated guidelines may need to consider and potentially account for how data is used by financial firms to prevent illegal activity. Internal fraud detection efforts and federal anti-money-laundering protections would have to be able to continue unencumbered.

"Without the ability to use data to identify and fight fraud, criminals will exploit the blind spot to commit crime," said Scott Talbott, senior vice president of government affairs at the Electronic Transactions Association. "This will undermine the system and unnecessarily make efforts to fight fraud more difficult."

### How can financial institutions prepare?

As the debate heats up, experts note that banks, even those who don't serve California customers, should consider reviewing their systems and procedures ahead of any additional changes to privacy law.

The challenge becomes wrangling numerous systems across an institution that may not handle customer information in a uniform way.

"If you were starting a bank from the ground up, you'd be able to sketch out on paper how all of the systems are going to work with a very clear view of how the data flows would operate," said Steve Durbin, managing director of the Information Security Forum, a cybersecurity research firm. "But very few institutions are in such a luxurious position."

The preparation effort starts with asking straightforward questions about data collection and use and following the trail from there, several industry officials said.

"For a larger bank to comply with something like the California law, the basic questions that they need to ask, simply, are what data do we have and where is it? What are we using it for and what do we need to tell customers about it?" said Scott Pearson, a partner at the law firm Ballard Spahr.

While the California law does include the GLBA carve-out, which limits the degree to which banks need to deal with data deletion, challenges are likely to remain, broadly, for financial services firms complying with new standards that give consumers more power over their information.

"If a customer says, 'Delete all of my data,' you need to know where all that person's data is to delete it, and

## States

### CALIFORNIA

- The California Consumer Privacy Act was approved in June 2018 and is set to take effect in January 2020
- The law requires companies with California residents as customers to abide by heightened disclosure standards and gives consumers considerable control over how their personal data is used
- The legislature approved language in September 2018 clarifying a carve-out for financial institutions under the Gramm-Leach-Bliley Act, but stopped short of exempting them from the law entirely

### VERMONT

- In May 2018, the state passed a law regulating data brokers that went into effect in January 2019
- Data brokers, which buy and sell consumer information, must now register with the Vermont Attorney General, make annual disclosures regarding privacy practices and data breaches and maintain a comprehensive information security program

### COLORADO

- Colorado passed a law in May 2018 that raises data security standards for companies with personal identifying information about state residents
- The law, which went into effect in September 2018, mandates that companies maintain reasonable security practices, appropriately dispose of documents containing consumers' personal information and ensure data is protected when transferred to third parties
- Consumers also must be notified of data breaches within a 30-day time frame

### NEW JERSEY

- In July 2017, the state passed a bill that limits a merchant's ability to collect information about shoppers and pass that data on to third parties. It has been in effect since October 2017

### NEW YORK

- New York State Sen. Brad Madison Hoylman proposed a bill in January that would give consumers the right to know what information is being collected about them from companies and how it's being disclosed to third parties — similar to California's new privacy law

### WASHINGTON

- A bill by state Sen. Reuven Carlyle, introduced in January, would give consumers the ability to find out whether their personal information is being collected by companies and whether it is being sold to others

you need to have a procedure and system for getting that done in a reliable manner," Pearson said.

"People have no idea how complicated these systems are and how many different systems there can be — it's just an enormously complex exercise," he said.

### Who's controlling the debate — the states or Congress?

Perhaps the biggest question for financial services companies — and the business community at large — is where policymaking around consumer privacy and data security are likely to play out.

The issue has attracted a bipartisan focus in Congress. Sen. John Thune, R-S.D., chairman of the Commerce Committee, has signaled interest, along with Sens. Ron Wyden, D-Ore., Richard Blumenthal, D-Conn., and Mark Warner, D-Va., among others. Sen. Marco Rubio, R-Fla., introduced legislation in January that would give the Federal Trade Commission the authority to update the country's consumer privacy laws. Various House lawmakers are said to be interested in the issue, too.

In addition, the banking committees might get involved.

"In order to fully embrace the immense benefits that can result from technological innovation, we must ensure proper safeguards are in place and consumers are fully informed," Sen. Mike Crapo, R-Idaho, chairman of the Banking Committee, wrote in a Jan. 29 editorial.

Crapo said that he plans to "explore legislative solutions" giving consumers more control over their data and greater disclosure around how the government and private companies are using their personal information.

Rep. Maxine Waters, D-Calif., who leads the House Financial Services Committee, also has vowed to examine the credit reporting system in the wake of the Equifax breach.

But, while the issue is likely to attract significant discussion — building on testimony from executives at Facebook, Amazon, Apple, Google and others last year — getting any federal plan into law this term will require overcoming some formidable challenges.

Attention span is one. There is often optimism around big issues like privacy early on, but that energy can dissipate.

"We're in the era of legislative deadlock at the federal level, and I think it is very likely that the states will step up and create more of a patchwork around privacy and security," said Mercedes Tunstall, a partner at the law firm Pillsbury Winthrop Shaw Pittman.

Still, it's worth noting that, over time, continued state action on these issues could create more interest in federal guidelines.

As more states pursue their own standards around consumer data protection and notification, companies are likely to become even more open to a national standard that simplifies the requirements they're expected to follow.

**"If a customer says, 'Delete all of my data,' you need to know where all of that person's data is to delete it," says Scott Pearson of Ballard Spahr.**

"This is the really happy time, at the start of the new Congress, where everything is back on the table," said Thomas Rosenkoetter, head of government affairs at BNP Paribas.

He's seen this same issue come up in the past, only to have it fade against other priorities. "To me, it's Groundhog Day," he said.

He cited the divided government and the potential for privacy legislation to span across several committee jurisdictions as factors that could impede progress in Congress this time around.

The intense focus on the 2020 presidential race also has the potential to drown out privacy, rather than give it more prominence, Rosenkoetter said.

That's why many expect that, while the national debate on privacy issues will keep burning, it's in the states that the most real action is likely to be seen.

"Companies with national footprints will find it operationally difficult to comply with 20 to 30 different state laws," said Sumner, the Blend compliance head.

That kind of patchwork approach would force companies to default their operations to the most restrictive state law, "resulting in a situation where the goal posts keep moving as each new state passes its own legislation with disparate obligations," she said.

But whatever the result, the issue remains one that banks will need to follow closely — and get involved in — in the months and years to come.

"There's the old saying, 'If you're not at the table, you're on the table.' Banks better be at the table," said Fine, who led the ICBA for 15 years before retiring last spring. "Whether they like it or not, banks will get pulled into this debate." □

# Did Regulators Fuel Volatility for Big Banks?

By Thom Tillis

The Trump economy has been strong. Buoyed by major Republican-led initiatives, including historic tax cuts and regulatory relief, the economy has been growing at an annual 3% clip and job creation is booming.

That's why many mainstream investors were shocked to see extreme financial market volatility at the end of 2018. For the full month of December, one of the broadest gauges of the U.S. stock market, the S&P 500, fell by 9%. This type of move should not be happening with the economic fundamentals we currently have.

Given that our economy appears to be in solid shape and corporate earnings are still growing, why all of a sudden was the equity market experiencing extreme 4% intraday swings? In addition, why were the fixed-income markets, particularly the interdealer repo market, also experiencing wild volatility?

As a member of the Senate Banking Committee, I think it is imperative that we find out an answer to this question. These types of market moves erode confidence in our system and make it less likely that hardworking Americans would be willing to participate in buying stocks and bonds. This loss of trust will hurt retirement savings and also dry up capital going into our markets, which will lower long-run economic growth.

While I am committed to finding out the answer this Congress, several market experts have already pointed to a culprit: a misguided and cumbersome series of bank regulations implemented by the Federal Reserve, but designed by an international organization based in Basel, Switzerland. With a banal name and an ever-expanding mandate, the Financial Stability Board could be behind some of the volatility we have seen.

Created at the 2009 G20 Summit in London, this board, along with other global bureaucrats, is charged with designating banks as "systemically important." Banks on this list were made to abide by special rules and regulations, one of which is known as the G-SIB surcharge.

The G-SIB surcharge is calculated just once at the end of every year. The problem with the G-SIB surcharge comes with its inherent complexity and the way it is calculated. Using 12 indicators grouped into five categories that are each risk weighted, the score boils down many subjective risks to just one number.

While the expansion of algorithmic trading and the move toward electronic trading desks makes it difficult to discern the underlying reasons for market moves, I understand incentives. Banks were pulling back liquidity in December in order to decrease their surcharge.

Combine this with the fact that during the holidays, especially after Christmas, many trading desks are thinly staffed, the potential for liquidity to be dramatically reduced in the equity and fixed-income markets becomes a real possibility.

This set of rules and its unintended consequences could be partly to blame for a lack of liquidity at the end of the year.

Although financial market volatility is driven by several factors, many of which are out of congressional control, the new 116th Congress, or perhaps the Federal Reserve using its "safety and soundness" authority, could do its part in reducing volatility by continuing to work on common-sense financial regulatory reform. I am committed to making the system safer, while at the same time more accessible.

Fixing the timing of this surcharge and enabling banks to provide liquidity when the market needs it are areas in which further oversight is warranted to ensure the proper functioning of our world-class capital markets and continued economic growth and momentum. □

*Sen. Thom Tillis, R-N.C., is a member of the Senate Banking Committee.*

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BLOOMBERG NEWS

## MICHAEL CORBAT

**"Right now, we see the biggest risk in the global economy is one of talking ourselves into the next recession as opposed to the underlying fundamentals taking us there."**

Citigroup's CEO, citing tight labor markets and healthy consumer confidence as positive economic indicators

## RON SHEVLIN

**"The Trump bump is turning into the Trump slump."**

Cornerstone Advisors' research director, after a survey showed a drop in optimism among bank CEOs about the year ahead

## BRIAN FORAN

**"December was a bad dream; we all freaked out at the same time."**

An analyst at Autonomous Research, attributing an average 14% drop in bank stock prices in December to investors' unfounded fears

## ART WILMARTH

**"Part of the problem is, the big banks have a lot of dirt under their fingernails. It's an accumulation of scandals and misconduct that weighs pretty heavily on them."**

George Washington University Law School professor, saying negative confirmation bias can prompt the public to dismiss positive stories about banks as outliers

## TIMOTHY MAYOPOULOS

**"Fintech seems to be the place where the action is."**

Former Fannie Mae CEO, on joining the mortgage software startup Blend Labs

BLOOMBERG NEWS

## ROD SIMS

**"We have to fix the cozy oligopoly."**

CEO of the Australian Competition and Consumer Commission, saying he wants the country's four largest banks to have more competitors

## ISAAC BOLTANSKY

**"We will have big-bank CEOs raising their right hand a lot more."**

Washington policy analyst, on Rep. Maxine Waters, D-Calif., chairing the House Financial Services Committee

## JAMES FAUCETTE

**"We are not expecting China to be a meaningful contributor to their growth, ever."**

Morgan Stanley analyst, about U.S. credit card companies like Visa and Mastercard still awaiting approval to set up their networks in China

## SAJID JAVID

**"We need to take action on all fronts to target the corrupt fraudsters who are lining their pockets with dirty money and living luxury lifestyles at the expense of law-abiding citizens."**

U.K. home secretary, on creating a government task force, called the Economic Crime Strategic Board, that works with banks to fight economic crime

BLOOMBERG NEWS

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