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Buying in

KMD Partners is the latest fintech company seeking to gain entry into the U.S. banking system by purchasing an existing depository

See story on page 4

Buyer	Seller	Seller's assets	Status
LendingClub	Radius Bancorp	$1.4 billion	Closed February 2021
SoFi	Golden Pacific Bank	$150 million	Announced March 2021
Jiko	Mid-Central Federal Savings Bank	$125 million	Closed September 2020
KMD Partners	Liberty Bank	$11.7 million	Announced June 2021

Source: Staff research

dailybriefing

CRYPTOCURRENCIES

Playing catch-up in crypto, banks ask core providers for help

By Penny Crosman
June 14, 2021

As banks recognize their customers' growing interest in cryptocurrency, they are asking the vendors that provide their core banking software — Fiserv, FIS, Finastra, Jack Henry, Temenos and Nymbus among them — for help in offering crypto services. The vendors say they are on it.

A survey that the New York cryptocurrency services company NYDIG conducted in January found that 46 million Americans own bitcoin; 81% say they would store it in their bank if they could. Banks have watched this money move out of their customers' deposit accounts with increasing alarm.

"Some banks see this as a threat," said Shuki Licht, chief innovation officer at the London-based Finastra. They fear they are losing business "because their customers are moving their money outside of the bank to invest the money in other places."

"We think that we've hit a tipping point with cryptocurrencies," said Byron Vielehr, chief digital and data officer at Fiserv, which is based in Brookfield, Wisconsin. "You now have tens of millions of Americans holding cryptocurrencies through a variety of different wallets. There's almost a trillion dollars sitting in bitcoin at this point. Most of the central banks are working on strategies for some type of a central bank digital currency, so, at least from where I sit, it's not a question of if, it's a question of how and how fast" banks will provide cryptocurrency services.

The core banking software vendors are all talking to or working with partners to let banks connect to or white-label cryptocurrency wallet software, either to let consumers buy, sell and hold bitcoin, or to let them simply see their cryptocurrency holdings alongside their regular bank accounts. Banks and their vendors are treading carefully, as the regulations governing what banks can do in this space have yet to be written.

"The use case we hear most about it is the ability to allow a consumer to take a hundred dollars out of their savings account, put it into bitcoin, hold it, see it, and then if they want, to trade out of it back to U.S. dollars," Vielehr said. "It's a pretty straightforward buy, hold, sell capability."

Some Finastra customers are going a step further: they're asking if they can be a part of decentralized finance, Licht said. This is the concept in which parties conduct financial transactions directly with one another, without an intermediary, such as a bank, in the middle. Other customers are looking to use smart contract and blockchain technology to replace manual processes, he said.

Nicole Harper, senior analyst and manager of strategy at Jack Henry in Monett, Missouri, said her company has seen an increase in client inquiries related to cryptocurrency.

"This is not surprising given the current hype, media attention, the changing U.S. policy and regulatory landscape under the Biden Administration, including movement toward a central bank digital currency, Coinbase going public, cryptocurrency service availability in popular apps, and growing consumer and institution acceptance," she said. "Banks are curious about which digital currencies to pay attention to, the use of cryptocurrencies for payments, and stablecoin."

At Nymbus, bank customers are asking about commercial and retail use cases, according to Sarah Howell, chief alliance officer at the Miami company. They're asking for the ability to buy, sell and hold cryptocurrency through a trading platform. Some are also asking to be able to offer crypto rewards for debit card spending or other types of customer behaviors that drive loyalty, Howell said.

FIS, of in Jacksonville, Florida, is also seeing "a lot of interest" in cryptocurrency from its bank clients, according to Rob Lee, head of global core banking and channels. They're asking "to be more educated around crypto currency and what services are offered to their clients today by other institutions and how that might impact their banking relationship," he said.

How the core vendors have responded

In May, FIS announced a partnership with NYDIG that will let FIS's core banking clients offer their customers the ability to buy, sell and hold bitcoin through their bank accounts. Banks that opt for this will set and keep the fees customers are charged and pay a monthly software-as-a-service subscription to NYDIG.

FIS will provide a user interface that connects consumers in-app with bitcoin trading services. NYDIG will handle the custody and trading of bitcoin transactions.

In late 2020, FIS and NYDIG partnered with Quontic Bank to enable the New York-based digital bank to be the first FDIC-insured financial institution in the U.S. to go live with a Bitcoin Rewards debit card.

"FIS is consulting with clients and various partners in the industry to explore additional use cases," Lee said. "We envision many places that we can support our core customers' interest in cryptocurrency

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services in the future."

Jack Henry customers that use the company's Banno digital banking platform can use its APIs to integrate with third-party crypto-custody providers. (Banno is a digital banking software startup Jack Henry acquired in 2014.)

"Ultimately, we aim to enable customers to buy, hold, and sell crypto assets within their digital banking experience without assuming balance sheet risk," Harper said. To that end, the company is working to provide integration with U.S.-regulated crypto currency exchanges for Banno and non-Banno-using customers.

Harper also said that when a U.S. central bank digital currency arrives, Jack Henry will be ready to support it as a new payment rail.

Fiserv is working with First Foundation Bank in Irvine, California, and NYDIG to enable the community bank to offer bitcoin investing to its customers.

"We're allowing for a transaction to happen where we take dollars off of a bank's core account processing system and we move it over onto the NYDIG custodial platform," Vielehr said. "The bitcoin is held there. We then aggregate up the view, so you can see the savings accounts or checking accounts sitting at the financial institutions and we aggregate the NYDIG view into that digital experience."

Fiserv has a data aggregation platform called AllData that competes with others like Plaid and Finicity. According to Vielehr, it's connected to 18,000 banks, credit unions, billers, card providers and lenders. Through a recent partnership forged with Verady, a company that provides tax and accounting services in the crypto space, consumers will also be able to see their cryptocurrency assets in another digital wallet at a provider like Coinbase or Kraken.

The Verady integrations will be available in the third quarter, Vielehr said. Fiserv is talking to a long list of other potential partners in the crypto space, he said.Finastra has been working with fintechs to help them build digital currency wallet apps built on its Fusion Fabric. cloud developer platform and marketplace. Some of these fintechs provide API access to any digital wallet, for instance to get access to Coinbase, and can enable banks to give customers a full view of all their accounts.

"This is very low-risk, the information is read-only," Licht pointed out. "You're not giving any permission to invest or buy crypto."

Others provide crytocurrency custody, and let banks white-label a digital wallet, so their customers can not only view their crypto holdings, but buy and trade crypto or borrow against their digital assets. The third-party custody provider stores the digital currency public and private keys and handles, KYC, risk and compliance.

In both cases, "we're just in the early stages," Licht said. "We're not in production yet, but we are working to expose this type of capability. By doing that, we can take it to the digital banking experience or more sophisticated scenarios around lending, investing and payments."

Nymbus is also working with crypto exchanges to let banking clients integrate their crypto capabilities with bank core systems.

Temenos announced in May that it was working with a Swiss fintech, Taurus. The two companies have integrated Taurus's digital asset and blockchain infrastructure with Temenos's Transact core banking software. In the future, Temenos, of Geneva, plans to support other forms of digital assets, like tokenized securities, or securities issued as smart contracts over a blockchain.

"What is interesting with tokenized securities is they would enable issuers to access capital markets for a fraction of the cost and time of a traditional IPO, either for regular company stocks, or for instruments usually reserved to wealthy or institutional investors like private equity funds," said Alexandre Duret, product director at Temenos. "Another benefit is the potential simplification of the settlement process and of the whole market infrastructure that supports it."

Regulatory uncertainty

A wild card for all these efforts is what regulators will do. Banks have gotten a mixed message about whether they can help customers buy and sell bitcoin and other digital currencies. This has dampened the enthusiasm of some bank clients, but not all, vendors say.

Last July, then-acting Comptroller of the Currency Brian Brooks posted a letter that gave national banks permission to issue and provide custody of digital currencies. Brooks's successor, Michael Hsu, has said the agency is reviewing this and other policies. The FDIC recently put out a request for information on digital assets.

"Banks are very, very confused about regulation," Licht said. "We are trying now to understand where the regulators are going. We are trying to come up with use cases that don't put the banks or the consumers at any kind of risk. The technology is here, but from a regulatory perspective, it's a challenge for the banks."

At Jack Henry, Harper said she sees banks proceeding cautiously due to the OCC's tentative stance.

"Some will seek to become early adopters in an effort to differentiate and gain early-mover advantage," she said. "Others will opt to watch from the sidelines to see how it plays out before choosing when or if to take the field. We don't see regulators like the OCC slowing down the research and discovery phase of cryptocurrency, which is where most of Jack Henry's market currently is."

Howell at Nymbus also has not seen regulatory uncertainty cause bank customers to put the brakes on their crypto plans.

"Michael Hsu's review of the OCC's crypto-related guidance under the administration of former acting Comptroller Brian Brooks is a reasonable request for any new leader stepping into a critical role in a matrixed regulatory environment," she said. "It indicates the OCC's intent to consider their actions within the context of other regulatory stakeholders in the U.S. banking system, to include the FDIC, Federal Reserve and the states."

ESG

Big banks support SEC climate disclosure plan, small banks dread it

By Neil Haggerty

June 14, 2021

WASHINGTON — A regulator's proposal to require climate risk disclosures for all public companies has divided large and small banks.

Representatives for large banks told the Securities and Exchange Commission in comment letters that they support informing investors about how financial institutions contribute to and are impacted by climate change, but they called for a safe harbor limiting legal liability for unintentionally misleading disclosures.

Community bankers, on the other hand, don't want the SEC to mandate climate disclosures.

"Mandatory disclosure requirements for all SEC filers are unnecessary and would only lead to excessive regulatory burdens on smaller publicly held companies," Christopher Cole, executive vice president and regulatory counsel at the Independent Community Bankers of America, said in a letter to SEC Chair Gary Gensler.

The SEC's request for information is part of broader attempts under the Biden administration to use the country's regulatory apparatus to force corporations to take stock of activities, such as lending to oil and gas companies, that contribute to climate change.

Analyts say larger banks, some which have have taken steps to curb lending to fossil fuel companies, are better prepared to handle a climate disclosure requirement because many have already alerted their investors about climate risks voluntarily. But community banks likely haven't faced the same pressure to be proactive.

"The largest banks have already started reporting some of this data in large part because of their size and their internal capacity to dedicate manpower to it," said Isaac Boltansky, director of policy research at Compass Point Research & Trading. "Community banks just haven't spent the time and are concerned regarding the costs."

The American Bankers Association and the Bank Policy Institute both indicated in their comment letters that investors are increasingly calling on institutions to provide information related to their activities that contribute to climate change as well as their exposure to climate change.

"Investor demand for environmental, social and governance-related information, and specifically information related to climate-related financial risk, has grown dramatically over the past few years, and the [SEC's request for information] is one in a growing array of national and global responses to the concerns expressed over climate risk," said Michael Gullette, senior vice president of tax and accounting at the American Bankers Association. "Appropriate disclosures from all business sectors will be key to understanding and addressing climate risk."

Lauren Anderson, senior vice president and associate general counsel at the Bank Policy Institute, which represents the largest banks, noted that the big banks have already starting disclosing climate-related information in response to investors.

"Many banking organizations have already taken several important climate-related actions, including publishing extensive disclosures publicly via their websites or through voluntary reports," Anderson said. "These actions are part of an increasing trend of registrants voluntarily disclosing climate information to investors, and we expect this trend would continue in response to investor interest in this information and registrants' desire to meet investor demand even absent SEC action on climate disclosures."

Ed Mills, a policy analyst at Raymond James, said large banks are likely "trying to shape the proposal versus trying to prevent the proposal."

"As an organization, your job is to kind of make sure there's an adequate transition period … and shape it in a way that is most livable for your members," Mills said.

Both the ABA and the Bank Policy Institute said that the SEC should include a safe harbor in its proposal to protect banks from lawsuits if they unintentionally disclose misleading climate-related information while trying to comply with the new regime.

"While their climate risk reporting systems may not yet be adequately developed to meet the requirements for financial filings with the SEC, SEC registrants should, nonetheless, be encouraged to disclose the climate risk management processes and the climate-related financial data they use," Gullette said. "Therefore, SEC registrants should be provided a safe harbor for their disclosures of climate risks and climate-related financial data that limits their liability for unintentionally misleading statements, amounts or estimates."

Anderson said that banks and other public companies would likely face costly lawsuits without a safe harbor.

"Absent a safe harbor, registrants are likely to face opportunistic lawsuits over disclosures that would be, at least in the short term, particularly uncertain," Anderson said.

But small banks are arguing that institutions should only voluntarily disclosure climate-related information to investors if that information is material.

In the ICBA's letter, Cole suggested that the SEC is stepping outside of its lane by focusing on climate change risk.

"The SEC should not politicize the agency and jeopardize its independence by taking a position on climate change and requiring annual disclosures of climate risks by all SEC filers," he said.

The industry comments come as Republican lawmakers have opposed regulators' efforts to assess climate change risks in the financial system.

"We do not believe that any further securities regulations to specifically address global warming are necessary or appropriate, and will only serve to further discourage firms from becoming publicly traded, thus denying significant investment opportunities to retail investors," all 12 Republicans on the Senate Banking Committee, led by Sen. Pat Toomey, R-Pa., said in a letter to Gensler and Allison Herren Lee, a Democratic member of the SEC.

SUBPRIME LENDING

Why a high-cost consumer lender is buying a tiny Utah bank

By Polo Rocha
June 15, 2021

The parent company of the high-cost digital lender CreditNinja has agreed to purchase a tiny Utah-based bank in a deal that may spark greater opposition than similar recent deals by other fintechs.

KMD Partners said that it has a deal to purchase Salt Lake City-based Liberty Bank, which has only $11.7 million in assets. Terms of the deal were not disclosed.

The acquisition could prove controversial because Chicago-based CreditNinja offers personal loans with annual percentage rates between 25% and 249%, according to its website. The lender focuses on borrowers with lower credit scores or little credit history who do not typically qualify for traditional bank loans.

High-cost loans have come under increased scrutiny from policymakers since the start of the Biden administration. Some fintechs, including LendingClub and Social Finance, both of which recently announced acquisitions of banks, cap the APRs on their consumer loans at or below 36%.

KMD Partners plans to use Liberty Bank to offer checking and savings accounts, credit cards and other banking services to underserved populations, according to executives involved in the deal. They said that the bank will also offer credit at more affordable rates to CreditNinja borrowers who have improved their credit standing.

"We want to make sure that as they get on a path to better [financial] health, that they have a full suite of digital banking and lending products at their fingertips in a single solution," said David Shorr, co-founder and executive chairman of KMD Partners, and a former CEO of the payday lender CashNetUSA, which is now a division of the publicly traded high-cost lender Enova.

If the deal is approved, Liberty Bank will operate separately from CreditNinja and be run by Marc Wintriss, the parent company's chief lending officer and a former regulator at the Federal Deposit Insurance Corp. and the Consumer Financial Protection Bureau.

CreditNinja would continue making high-cost loans, acting as the direct lender in 13 states and in partnership with Utah-based First Electronic Bank in states that restrict high-cost loans from non-banks.

High-cost lenders face close scrutiny from state regulators, congressional Democrats and consumer advocates who say that loans with triple-digit APRs put vulnerable Americans at risk of being trapped in debt cycles.

As the FDIC reviews the proposed merger, it should shut down CreditNinja's high-cost loan program, and also eliminate similar partnerships at other FDIC-supervised banks, said Lauren Saunders, associate director of the National Consumer Law Center.

"The way to financial inclusion is not by offering somebody a predatory loan with the promise that you will graduate them eventually into a reasonable one," Saunders said. "People who are struggling need reasonable, affordable credit today, not high-cost credit that just puts them further behind."

KMD's Shorr argued that CreditNinja provides a vital source of credit to Americans who generally cannot qualify for bank loans. The lender ensures that its customers are able to repay their loans, which are not meant to be long-term solutions, he said.

"Our goal is to get them in the ecosystem, get them the credit they need and move them on a path towards better financial health," Shorr said.

The companies expect to close the deal by the end of 2021, pending approval from the Utah Department of Financial Institutions, the FDIC and the Federal Reserve Board. KMD Partners would become a bank holding company regulated by the Fed, with Liberty Bank and CreditNinja operating as separate subsidiaries.

The deal seems likely to be approved, though it does raise some concerns about the mingling of higher-cost credit with traditional banking, said Ed Mills, Washington policy analyst at Raymond James. He suggested that KMD's plan to shift CreditNinja borrowers to cheaper credit options is likely to get a favorable reception from policymakers.

"How they do it is going to be the real issue," Mills said.

The deal is the latest example of a fintech trying to enter the banking system by acquiring an insured depository institution, noted Allen Denson, a partner at the law firm Venable. LendingClub closed its acquisition of the $1.4 billion-asset Radius Bank in February, and SoFi announced plans in March to purchase the $150 million-asset Golden Pacific Bancorp.

For some fintechs, buying an existing bank might be less expensive than starting a new bank from scratch. An acquisition can also provide more certainty than less-tested options like applying for the Office of the Comptroller of the Currency's fintech charter, which remains the subject of litigation.

"I think that there are opportunities like this out there, so I think that this could be a really interesting trend that happens over the next few years," Denson said.

Liberty Bank, which was founded in 1956 and has one branch in Salt Lake City, offers residential loans and other types of personal credit. The bank's president and CEO, Kendall Phillips, said that KMD's digital capabilities will help ensure that Liberty can "continue to serve our customers in new and innovative ways within an increasingly competitive environment."

"I look forward to passing the reins to Marc [Wintriss], whose deep experience in lending, consumer protection, and risk management will serve Liberty Bank and our community well," Phillips said in a written statement.

Wintriss, the bank's proposed CEO, is the former chief credit officer of Target Bank and First Electronic Bank, the Utah bank that partners with CreditNinja on high-cost loans in some states. At First Electronic, Wintriss helped develop the bank's lending partnership program, which also works with the high-cost lenders OppFi and Personify.

VENTURE FUNDING

VCs boost investment in Black- and Latinx-owned fintechs

By John Adams
June 14, 2021

The spark for a business idea often comes from the founder's personal experience or a plan to serve a specific market. That can create unfair odds when the financial gatekeepers don't have the background to relate.

Technology investments are not distributed in a manner anywhere consistent with the United States' racial and ethnic composition, and as a result there's a risk that financial innovations can be missed and new markets overlooked. Across all technology categories in the U.S., the venture funding gap for Black or Latinx-founded startups is staggering. Since 2015, about $15 billion has been raised by Black- or Latinx-founded technology startups, which is 2.4% of the total venture capital raised during that time, according to Crunchbase.

"We are focused on serving the Latinx community, and it has taken a while for the VC community to really understand the customer pain points we are addressing," said Sam Ulloa, CEO and co-founder of Listo, a San Jose, California-based payment and financial services company that recently received funding from Mendoza Ventures, a Latinx-owned VC. "The stats clearly show that it is more difficult for Black- and Latinx-founded fintechs to obtain VC funding. There are multiple reasons, one of which is simply a lack of access to the right networks; the second is that there aren't enough Black and Latinx VCs."

Mendoza Ventures in Boston is one of the firms working to address a funding gap for technology startups in underserved markets with a specific focus on pre-seed investments, or spotting an innovative concept early on. Adrian Mendoza co-founded the organization, one of the first Latinx-owned VC funds on the East Coast, with his wife Senofer in 2015.

"There's a tremendous opportunity for fintech to democratize access to financial products," said Mendoza, general partner of the firm.

Seventy-five percent of the firm's investments go to companies that are led by immigrants, people of color or women, mostly in AI and fintech. "The tech has to be there, but a diverse team can create an impact and reach and improve financial conditions for a new market," Mendoza said.

Listo's model, including its bilingual website, is designed for the needs of its target audience. It uses an internal algorithm based on prior transactions to create risk profiles for people who often do not have credit scores. Listo then offers digital payment products, microloans and insurance to businesses and consumers that are largely cash-reliant and can have liquidity challenges.

"It is natural for VC investors to invest in things they can relate to," Ulloa said. "That's another reason why diversity is so crucial."

Root cause

The VC funding gap for fintechs and payment companies starts with a cultural imbalance in the investment industry. Venture capital is a field that is numerically dominated by white men on both sides — investing and receiving — said Katherine Klein, vice dean of the Wharton Social Impact Initiative at the Wharton School of the University of Pennsylvania.

"VC is a highly relational, predictive business, in which investors often make decisions and predictions about an early-stage company's future success based in large part on relationships and 'gut instinct,' " Klein said. "Relationships matter, because only a very small set of early-stage companies and their founding teams can secure the attention of VCs."

That relationship gap can be traced directly to the ownership of investment companies.

According to the Knight Foundation, "substantially diverse-owned" and "majority diverse-owned" firms manage 1.3% of assets under management in mutual funds, hedge funds, private equity and real estate in the U.S. (Majority diverse-owned firms have 50% or more owners who are nonwhite male, while substantially diverse-owned firms have 25 to 49% nonwhite male owners.)

"It's not surprising VCs pay more attention to founders they meet through their personal networks," Klein said. "But, because our social networks tend to be homogeneous, VCs are exposed to and are most likely to invest in people who are like them."

The gap in VC ownership does not correlate to performance, according to Knight, which found no difference between the performance of diverse-owned and nondiverse firms. Diverse-owned firms are also more likely to invest in diverse companies, according to a Fairview Capital study.

VC firms can change their recruitment practices to bridge the representation gap, according to Klein.

"It's really important for VCs and other decision makers to think long and hard about the indicators they use to screen candidates," Klein said. "How valid are these indicators? By relying on these indicators, who are they excluding? And, how might they evaluate and predict quality in a way that is more valid but less restrictive?"

'Talent is ubiquitous'

Fairview found some progress, noting 69% of women- and minority-owned private equity firms in the U.S. market in 2019 were pursuing venture capital investments, up from 62% in 2018. The trend is attributable to an acceleration of new VC firms focused on early-stage investments, which are key to a company getting off the ground.

"Often startups led by diverse founders have a hard time even getting to a Series A round," said Trish Mosconi, executive vice president, chief strategy officer at Synchrony, which recently set aside $15 million for female and minority-backed VCs. "To start narrowing the funding gap, diverse founders need access to capital at an earlier stage so their companies have a better chance to grow."

Mendoza's investment strategy often leads it to firms that develop and sell payment and banking products based on nontraditional metrics. Mendoza portfolio firm Finch offers a combination of checking and an investment account with a link to an exchange traded fund. There's also a debit card that tracks payments and routes transactions to investments and wealth management services.

The Boston-based company's product is designed to address wealth inequality, another dangerous gap. The median wealth for U.S. white households grew about $54,000 over the past decade and a half, while the median wealth for U.S. Black households stayed stagnant, according to McKinsey, which estimates the perpetuation of these trends will cost the U.S. economy as much as $1.5 trillion, or 6% of the GDP, by 2028.

The pandemic's impact was disproportionate, creating a greater economic challenge for Black and Latinx-owned businesses, which have more difficulty accessing credit and greater liquidity issues than white-owned small businesses, according to McKinsey.

"One of the things that is financially hurting minorities and millennials is they are sitting on cash … they are losing out on net worth," Mendoza said. "And that cash can go into wealth generation."

Established financial firms are starting to address the VC gap. In addition to Synchrony's recent investment, PayPal in late May announced it would invest an additional $50 million in 11 Black and Latinx-led early-stage VCs, following an earlier $50 million in October 2020.

In an email, a PayPal spokesperson said PayPal Ventures has made about 40 investments in the past four years in "promising startups, mostly series B and larger funding rounds in fintech and e-commerce space." PayPal realized the majority of Black and Latinx founders often struggle to raise early-stage funding, leading to the $100 million commitment, the spokesperson said.

"Talent is ubiquitous, but access to capital is not. This is evident in the lackluster percent of venture dollars that make their way from VCs to Black and Latinx founders. To solve this problem, like any other, we must attack it at the root," said Marlon Nichols, managing general partner and cofounder of MaC Venture Capital, a Los Angeles-based VC partly backed by PayPal.

MaC Venture's current portfolio is invested in 76% Black, Latinx and female founders, with recent investments including StoreCash, a San Jose, California-based payment company that allows users without bank accounts to request, receive and use funds via their smartphones. There's also a StoreCash payment card.

"The larger VC industry needs to focus more on entrepreneurs at the early stage and invest in those who are solving the problems that would benefit the majority of our society," Nichols said.

Mastercard this month launched a new track for its Start Path program for new technology companies, focusing on startups with Black, Indigenous, people of color and/or women founders. The program includes partnership readiness training, coaching, introduction to investors and in some cases grants.

The VC funding gap is particularly acute for Black women founders, which have received 0.27% of VC funding during the past two years, said Michael Froman, vice chair and president of strategic growth for Mastercard, who stressed mentorship and guidance as part of the solution.

"A startup's ability to scale increases exponentially when larger companies with trusted relationships can make introductions to its partners, but also offer the startup's services as part of a proposed solution to customers," Froman said.

Another VC, the two-year-old Chicago-based Chingona Ventures, has focused its investments on payment technology that addresses changes in business practices and in consumers' shopping habits, with a focus on finding diverse developers and founding teams.

Chingona's portfolio includes Finix, a San Francisco-based company that offers a payment facilitation platform as a service that handles merchant onboarding, a payment gateway, tokenization, reporting and reconciliation that's designed for a range of businesses that may not have digitized their payments in the past.

"The restaurant space got hit the hardest. In many cases the restaurants weren't prepared to track payments digitally and had to adjust quickly to that trend," said Samara Hernandez, a founding partner at Chingona. "And that will continue going forward."

Another Chingona portfolio company, the Los Angeles-based Reel, allows users to create an account to gradually save toward purchases, with a calculator that displays how long it will take to afford the item based on a current rate of spending.

It's a buy now/pay later model in reverse, based on saving instead of debt.

"There are a lot of consumers that don't want debt and don't want to put purchases on a credit card," said Hernandez, who has worked in venture capital for more than seven years and has also worked at Goldman Sachs.

An additional Chingona portfolio company, Suma Wealth in Los Angeles, offers consumer wealth management products to the Latinx community, selling a mix of payment cards, investments, savings and other financial products. There are also financial education products for young people.

"They serve an educated market with a high income that many companies don't know how to target," Hernandez said.

COMMERCIAL REAL ESTATE LENDING

Banks' biggest CRE headache: A dearth of originations

By Allissa Kline
June 14, 2021

In some ways, the outlook for commercial real estate lending is brightening.

Lodging — the sector hit hardest by the coronavirus pandemic — is coming back as people resume traveling. Retail is moving in the right direction as consumers start spending money at stores and restaurants. Even the office sector, CRE's pandemic wild card, is holding its own for now.

But while fears of mass defaults have eased as the economy continues to improve, CRE lenders now have another worry: Weak loan demand.

Loan originations are still nowhere near pre-pandemic levels and industry watchers say demand is likely to remain tepid at least through the end of this year, largely because companies are sitting on so much cash that they don't need to borrow. Moreover, competition for quality CRE loans is escalating, threatening to further narrow banks' profit margins on loans.

"There's a lot of money out there ready to be deployed and there's a lot of competition on new loans," said Matt Anderson, a managing director at Trepp, a data and analytics firm that tracks commercial real estate trends. "And that's probably going to eat into the juicy margins that banks might have been hoping for."

Across the industry, total CRE originations on commercial mortgage loans and construction and land loans are still well below pre-pandemic levels. Among large and midsize banks surveyed by Trepp, originations in the first quarter totaled $5.8 billion, down 51% from a year earlier and 63% from the fourth quarter of 2019.

Trepp data shows that first-quarter loan originations were down across all categories except commercial mortgages for multifamily properties and construction and land loans for office and retail sites.

Commercial mortgages for office, retail and lodging loan volumes were just 33%, 42% and 10%, respectively, of the 2019 quarterly averages for each of those categories, the data shows.

Trepp's findings are based on loan level and performance data it collects every quarter from large and mid-sized commercial banks and inputs into an anonymized loan level repository called T-ALLR. The data represents nearly 10% of all CRE loans at banks in the U.S.

Apart from competition, record low interest rates and a flood of deposits in the banking system pose the biggest threats to banks' net interest margins. Banks have lots of excess liquidity, but not enough loan demand to put those deposits to use.

Overall, the industry's net interest margin in the first quarter declined to 2.56%, the lowest level on record in the Federal Deposit Insurance Corp.'s Quarterly Banking Profile. The previous low was 2.68% in the third quarter of 2020, the FDIC said. By contrast, the industry average was 3.28% in the fourth quarter of 2019.

"The anemic loan production we've seen over the last year, that's been a contributing factor to the weak net interest margins we're seeing at banks," Anderson said. "Deposits are flowing in, but banks for the most part haven't been turning around and making new loans."

Among the factors affecting demand for CRE loans are higher building costs, brought on by supply chain issues, and a shortage of skilled labor. With materials and workers in short supply, some developers are putting off construction projects, experts say.

And for those loans that are being made, banks are facing increased competition from nonbanks, according to Mark Fawer, a partner in the real estate practice of Greenspoon Marder law firm. Private equity funds in particular, which have been eager to do CRE lending, have been "very aggressive" with pricing lately, Fawer said.

Private equity "can offer loans at cheaper rates" and wind up with "very high returns," he said.

Some bankers are optimistic that demand is poised to pick up. At the $2.1 billion-asset Evans Bancorp in Williamsville, New York, the loan pipeline is heavily weighted toward CRE, said President and CEO David Nasca.

"We're getting production and that will help offset any margin compression," he said. But, he added, other banks "that aren't getting a lot of production and are sitting on lots of deposits" could struggle with profitability.

Increased volume will help ease the margin pressure, Piper Sandler analyst Frank Schiraldi agreed. But he isn't expecting demand to meaningfully pick up until companies start spending all the cash they are sitting on.

"At the end of the day, we're looking for origination volume to come back," Schiraldi said. "But I think some of that hopefulness will get pushed back into early 2022."

Perhaps the best news for banks on the CRE front is that credit quality has held up better than expected, as evidenced by the fact that so many banks have been releasing loan-loss reserves they had built up early in the pandemic. .

"We feel pretty good in terms of credit losses on the CRE book," Don McCree, the head of commercial banking at the $187 billion-asset Citizens Financial Group in Providence, Rhode Island.

"We took a couple of big write-downs in the middle of last year on a couple of mall exposures, so that's kind of behind us and we feel like we have line of sight into any future CRE losses," McCree said during an industry conference this month. "You could always have a surprise, but we think things are stabilizing pretty nicely."

At PNC Financial Services Group in Pittsburgh, loan-loss reserves were released in the first quarter, but the $560 billion-asset company "actually continued to build reserves against the real estate sector," Chairman and CEO William Demchak said at a separate industry conference also held this month.

"There continue to be clients out there that are hurting," Demchak said. "We're well-reserved for it, but that's going to play out over a long period of time, I think."

For many banks, the office sector remains a big question mark. How the pandemic will affect return-to-office plans and how much working space employers will need or not need has yet to play out.

"There's a concern that office is being propped up a bit by the fact that office leases tend to be long-term," Schiraldi said. "In general, it's a property type where it may take a little bit longer to see a fair reflection of what the values are."

REVENUE STREAMS

Dimon warns of bigger trading revenue drop after COVID boom

By Bloomberg News
June 14, 2021

Wall Street's pandemic-era trading boom could be drawing to a close, with JPMorgan Chase CEO Jamie Dimon signaling a 38% decline in trading revenue from a year ago — a bigger drop than previously expected.

Trading revenue at the largest U.S. bank will drop to just north of $6 billion in the second quarter, Dimon said Monday at a Morgan Stanley virtual conference. That tally could end up lower than the already reduced average analyst estimate of $6.5 billion, according to data compiled by Bloomberg.

The drop comes after a year of pandemic-induced market volatility proved lucrative for the biggest Wall Street operations. JPMorgan shares dropped as much as 2% after Dimon's comments, continuing a slide after the stock hit an all-time high earlier this month, with other bank stocks declining as well.

This quarter will be "more normal" for fixed-income and equities trading, meaning "something a little bit north of $6 billion, which is still pretty good, by the way," he said. Investment banking revenue, meanwhile, will be driven up by an active mergers-and-acquisitions market, resulting in what "could be one of the best quarters you've ever seen" for that business.

Dimon also pared back JPMorgan's forecast for net interest income, predicting $52.5 billion this year, down from a previous estimate of $55 billion for 2021.

"I know it's a little disappointing," Dimon said.

Bank chiefs warned of muted loan demand as they discussed first-quarter results in April, describing an environment in which borrowers, still flush with stimulus cash, were paying down balances and weren't demanding more financing. Dimon said at the time that "this is not bad news about loan demand — this is actually good news."

As far as trading goes, Daniel Pinto, co-president at JPMorgan, said earlier this year that he expects "more normalized volumes in line with 2019 with some degree of growth." The biggest banks' Wall Street units thrived last year with government stimulus, Federal Reserve intervention and heightened volatility spurring a trading bonanza.

Morgan Stanley CEO James Gorman also tempered expectations on Monday ahead of bank earnings next month. At the virtual conference, he cautioned that the investment bank's revenue will be nowhere near the "gangbusters" level seen in the first quarter. The performance will still be better than the numbers Wall Street had been producing heading into the pandemic.

Gorman's bank, which in past years set itself a target of at least $1 billion in quarterly revenue from its recovering fixed-income unit, had a couple of quarters where that unit posted as much as $3 billion. While it will fail to match that pace this quarter, the division's haul will still end up well above the $1 billion target, Gorman said.

BRANCH NETWORK

BofA ventures into Kentucky with biggest U.S. banks expanding

By Bloomberg News
June 14, 2021

Bank of America is opening retail bank branches in Kentucky for the first time as the largest U.S. lenders eye expansion.

The Charlotte, North Carolina-based bank is adding three locations in Lexington, with plans for a fourth next year, according to a statement Monday. Since 2015, Bank of America has expanded into several new markets, including Denver, Minneapolis and Pittsburgh, with 90 new locations and more than 700 ATMs added in the past year and a half.

"It's a growing market," Aron Levine, the bank's president of preferred and consumer banking and investments, said of Kentucky in an interview. "There's really strong employment numbers. And the expectation is continued growth."

Other major banks have recently expanded or detailed plans for doing so. JPMorgan Chase is moving into new states and spending billions annually on digital offerings. Last month, Citigroup Chief Executive Jane Fraser reiterated her company's interest in opening additional retail locations.

The entry of banking giants into new markets has helped spur smaller lenders to merge to remain competitive.

DIGITAL BANKING

BMO signs deal with Amazon division to help digital shift

By Bloomberg News
June 14, 2021

Bank of Montreal picked Amazon.com's web-services division as its preferred cloud provider to help the bank modernize operations and introduce new digital applications.

The deal includes using Amazon Web Services technology for the bank's call centers and for remote-work tools for its employees, as well as employing the tech firm's machine-learning capabilities, Seattle-based Amazon said. Financial terms of the agreement weren't disclosed.

Big Canadian banks have been adopting more digital services after the pandemic shut down or reduced capacity at their physical locations. The Amazon deal will help Bank of Montreal make its own operations more efficient, enabling it to convert customer-service conversations into text transcripts, digitize certain documents and more easily calculate the market and credit risks in its lending portfolio, said Victor Tung, the lender's U.S. chief technology and operations officer.

"Digital isn't just a channel, it's a way we operate in every part of the business," Tung said in an interview. "A big part of that is data analytics and user-friendly tools and common platforms that allow us to grow better and faster services."

Bank of Montreal also will start a new cloud-skills training program for both its information-technology and nontechnical employees, Amazon said.

M&A

Cornerstone Home Lending to buy Texas community bank

By John Reosti
June 14, 2021

Cornerstone Home Lending is buying the $212.6 million-asset Roscoe State Bank in Roscoe, Texas.

Cornerstone, of Houston, did not say when it expects the deal to close or how much it agreed to pay for Roscoe State Bank, which first opened its doors in 1906.

Owning a bank will allow the mortgage lender "to significantly expand product and service offerings to our hundreds of thousands of customers and referral sources throughout the country," Marc Laird, founder, chairman and CEO of Cornerstone, said in a Monday press release Monday.

Cornerstone has helped finance more than 430,000 mortgages since its launch in 1988. The combined company will have $2 billion in assets and $300 million in equity capital, according to Cornerstone.

Roscoe State Bank operates three branches in Roscoe, Sweetwater and Bastrop, near Austin. Chairman and CEO John Jay will join Cornerstone's board of directors and play an active role in its operation.

Cornerstone is "the perfect fit for our bank as we combine two family-owned organizations that share a similar culture and a commitment to building long-term relationships," Jay said in the release. Jay's family has owned Roscoe State Bank since 1976.

A mortgage company acquiring a community bank is by no means unheard of. DLP Real Estate Capital announced plans to acquire $98 million-asset Sunnyside Bancorp in Irvington, New York, for $12 million in March. Gateway Mortgage Group in Tulsa, Oklahoma, acquired the $314 million-asset Farmers Exchange Bank in Cherokee, Oklahoma, in May 2019.

BANKTHINK

Fed Gov. Quarles is wrong about bank capital buffers

By Jeremy Kress and Gregg Gelzinis
June 14, 2021,

In a speech to Wall Street lobbyists on June 3, Federal Reserve Vice Chair for Supervision Randal Quarles touted what he views as his most significant policy accomplishments during his tenure. Among the achievements Quarles highlighted was the Fed's decision not to activate the countercyclical capital buffer (CCyB) — a discretionary cushion of loss-absorbing capital — in the lead-up to the COVID-19 crisis.

Quarles' views about the CCyB, however, rest on a misleading narrative. When considered in the appropriate context, the Fed's decision not to use the CCyB in the lead-up to the pandemic was deeply flawed, and Quarles' revisionist history could threaten the nascent economic recovery if emerging financial stability risks go unchecked.

The Fed established the CCyB in 2013 as an extra capital buffer it could require the largest banks to maintain "when systemic vulnerabilities are meaningfully above normal." In such circumstances, requiring banks to accumulate an extra capital buffer could slow the growth of credit bubbles and prevent the economy from overheating while, at the same time, increasing the resilience of the banking system to a potential downturn.

During the historically long economic expansion of the 2010s, numerous economists and policymakers, including former Fed Chair Janet Yellen, urged the central bank to activate the CCyB in light of escalating risks. Meanwhile, many other developed countries — including France, Germany and Hong Kong — increased their countercyclical buffers.

Despite this pressure, however, the Fed consistently declined to activate the CCyB, voting annually to maintain the buffer at 0%. In 2019, Gov. Lael Brainard dissented, asserting that escalating financial stability risks necessitated raising the CCyB.

Two years and one pandemic later, Vice Chair Quarles now insists that calls to activate the CCyB were "mistaken" and that the Fed was correct not to turn on the buffer. He maintains that the U.S. banking system performed well during the pandemic even without the additional capital cushion and that activating the CCyB pre-pandemic could have impaired lending.

Quarles' conclusions, however, are misguided for five reasons.

First, Quarles' claim that U.S. banks thrived during the crisis overlooks the unprecedented government support that boosted the economy and the financial system. At the onset of the pandemic, Congress and the Federal Reserve injected trillions of dollars of fiscal and monetary stimulus that shielded households, companies, municipalities, and ultimately, banks from more severe financial stress. It is disingenuous for Quarles to conclude that the banking system performed well during the pandemic without acknowledging the central role government support played in bolstering banks.

Second, Quarles wrongly asserts that the Fed did not need to activate the CCyB because the United States' baseline capital requirements "have been set so high" that "our CCyB is effectively already 'on.' " This is revisionist history. When the Fed established its CCyB framework in 2016 — with the support of now-Chair Jerome Powell — it explicitly envisioned the CCyB as an extra capital buffer on top of its minimum capital requirements, not as a cushion somehow covertly embedded in existing capital rules.

Third, Quarles' disavowal of the CCyB in favor of "high and hard" through-the-cycle capital requirements — a sentiment echoed by Chair Powell in January — ignores the Fed's congressional mandate. The Dodd-Frank Act directed the Fed to make capital requirements countercyclical so that banks' capital buffers expand during times of economic expansion and decline in times of economic contraction. Countercyclical capital requirements are not just good policy — they are the law. Quarles and Powell are wrong to ignore Congress's instructions.

Fourth, Quarles downplays the fact that an active CCyB could have served as a useful release valve to safely relax capital requirements at the onset of the pandemic. Recall that in April 2020, the banking agencies excluded cash and Treasuries from the supplemental leverage ratio (SLR), insisting this change was necessary to ensure banks could continue lending during stress. In practice, this carve-out permitted the largest bank holding companies to reduce their capital levels by up to $76 billion below levels previously deemed safe. Had the Fed turned on the CCyB before the pandemic — as many other central banks did — the U.S. could have deactivated the buffer when the pandemic hit in lieu of weakening the SLR and other elements of the capital framework.

Finally, Quarles misleadingly claims that other countries that activated their countercyclical buffers did not have higher loan growth during the pandemic than the United States. Focusing narrowly on lending outcomes, however, ignores one of the central purposes of the CCyB: to absorb potential losses on bank balance sheets. While significant losses fortunately did not materialize in 2020 — thanks, in large part, to robust government support — they could in a future crisis. Dismissing the CCyB, therefore, would be dangerously shortsighted.

Rather than casting aside the CCyB, the Fed should strengthen the buffer and ensure that future policymakers cannot ignore it as Quarles has done. As an initial step, the Fed should set the CCyB to adjust automatically based on predetermined financial stability metrics, such as the credit-to-GDP ratio, asset valuations, real-estate prices, and financial leverage. Automating the CCyB in this way would guard against future policymakers' unwillingness to use this important tool. Similarly, the Fed should complement the risk-weighted CCyB with a countercyclical leverage buffer to further protect against boom-and-bust economic cycles.

At a minimum, however, the Fed must restate its commitment to activating the CCyB when risks are meaningfully above normal. With cryptocurrencies, meme stocks, SPACs, housing prices and nonbank leverage pointing to frothiness in financial markets, now would be a good time to revive the CCyB. Quarles' successor as vice chair would be wise to consider activating it.

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