LaunchPad Lab

# Competing with FinTech

How community banks can compete with online lenders and Fintech firms.

# Mortgage Industry Influx

In an industry that still uses fax machines, paper printouts, and snail mail for conducting business, it isn't a surprise that in 2018, financial innovations and technologies are challenging traditional practices in mortgage origination and processing. This is not to say that mortgage demand is declining; Freddie Mac predicts 1.8 trillion dollars in new mortgage generation over the next 5 years, a massive increase.

It seems there is disconnect between new mortgage innovations and traditional lenders with only seven percent of bank processes being conducted fully online. The slow pace at which banks have begun to integrate digital technologies into their lending sector has left them on the outside looking in.

All of these developments come on the twenty-fifth anniversary of Bill Gates notable speech claiming that banks were "dinosaurs." Now it seems that Gates' decades-old observation is starting to look more and more correct as new financial tech (fintech) companies have begun providing more personalized, transparent offers coupled with sleek UX design. These disruptions have led to traditional banks losing market share. No longer do industry giants JP Morgan, Bank of America, and Wells Fargo control 50 percent of all new mortgages. In fact in 2017 six of the top ten lenders were "non-banks" such as Quicken Loans or Loan Depot.

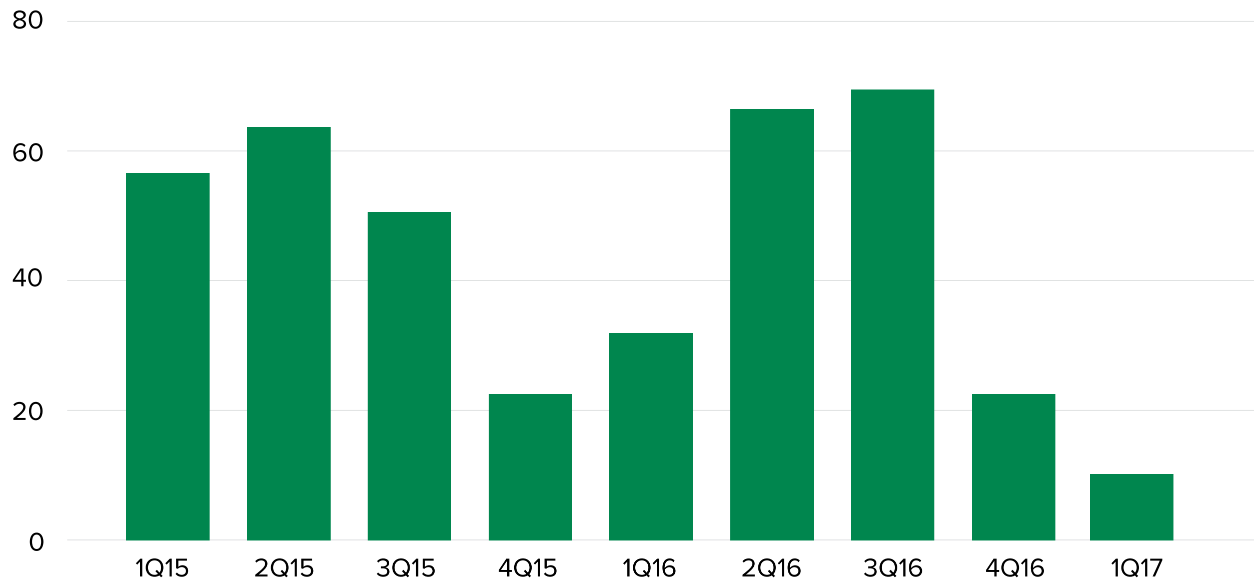
# “Silicon Valley Is Coming”

The fact is major traditional players in the mortgage industry are entering the digital space because they are falling behind their nonbank counterparts. This culture shift signifies a need for smaller lenders to find their place in online lending. A 2018 study by professors at Columbia, Stanford, and the University of Chicago found that limited technology adaptation by traditional banks accounts for 35 percent of “nonbank” growth every year.

The sudden flood of new lenders has left traditional banks searching for new cost cutting and profit maximizing methods to combat mortgage profitability trending to zero. In 2017 competition online has resulted in 40 percent of traditional lenders to see revenue fall in part due to their inferior digital lending applications.

On average it takes $7,000 dollars, 400 pages, 25 employees, and 50 days to process a loan, so moving online should come as a simple cost saver for traditional lenders. FinTech institutions, on the other hand, boast an efficient process that has cut costs and is less susceptible to backlogs during high lending periods.

These realizations have led to one of the largest mortgage originators to join the digital wave. Bank of America launched its digital mortgage service April 11, after acquiring several smaller FinTech, lending startups. Bank of America and its large counterparts




aren't the only ones entering the digital sector. 56 percent of small lenders indicated they wanted to expand or improve their digital banking applications. Massachusetts based Eastern Bank created its own digital front end in an attempt to integrate into the digital market.

The reason behind Bank of America's sudden shift is almost certainly due to the fact that FinTech companies are charging considerably higher interest rates. The same Stanford and U Chicago study found that non traditional lenders charge a convenience premium of 14 to 16 basis points on a single loan.

Fintech firms are also winning in terms of attracting borrowers on both ends of the income spectrum. By making loans across a range of socio economic levels these firms have returned default rates 20 percent lower than traditional lenders.

So just how are these firms able to reduce risk and increase premiums while continually beating major lenders? The simple answer is convenience. Borrowers want a simple, responsive process that allows them to skip the complex process of the past. In terms of risk, lenders want a large data pool to collect information on which customers to lend to, and how to best target those premium borrowers. Online origination offers lenders a whole new collection of data to do exactly that.

# User Experience Centered

FinTech lending is the mortgage business of the here and now. FinTech firms control a major share of the refinancing business and are now lending to a vast majority of high-income borrowers. Their efficient setup and low default rate has led them to integrate new technologies that bundle services on the customer facing side. Take for example, Rocket Mortgage, which produces lending offers within minutes.

This conglomeration of services is a significant cause behind the disruption in the mortgage industry. Borrowers now know that traditional banks are no longer the only or even best option for loans. Fintech firms can give borrowers the convenience they want along with the ability to more fully participate in the transaction.

Mortgage lending and its online process have become centered on this user experience. Nonbank lenders have finished first in customer satisfaction for the past seven years. By giving the customer a choice in the process, these companies are engaging potential borrowers and limiting those that drop off during the process. Only around 18 percent of conventional bank customers completed even the most basic of online applications.

# Success Driven

Traditional lenders can have success by emulating these FinTech firms while combining the strengths in personal interaction they have long enjoyed.  The best of the FinTech industry has been successful at discovering and understanding what needs borrowers have and promoting just how their product accomplishes that. It is more than just about an aesthetically pleasing design, the focus is on functionality and convenience for the customer.

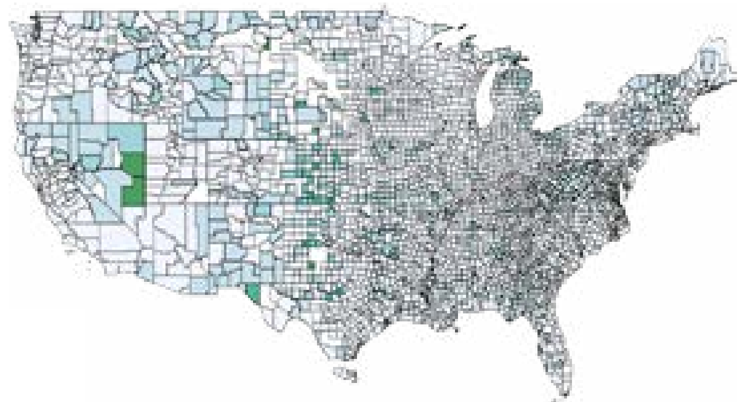
What fintech lenders seemed to have missed and the area that conventional banks can be of better assistance is customer retention. Extreme prioritization of acquiring new customers has left these nonbank lenders vulnerable. It is far more cost and resource efficient to focus on customer retention rather than acquisition. By supplementing efforts for new customers and investing in experiences for existing customers through the digital space, traditional lenders can not only compete, but surpass fintech firms.

**Market Share of nonbank lenders by County**

Source: Federal Reserve Bank of New York

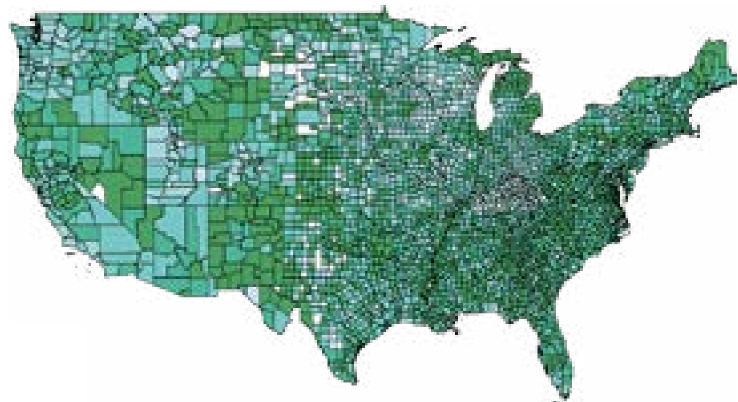
**Calendar Year 2010**

- >15%
- 12-15%
- 9-12%
- 6-9%
- 3-6%
- 0-3%



**Calendar Year 2016**

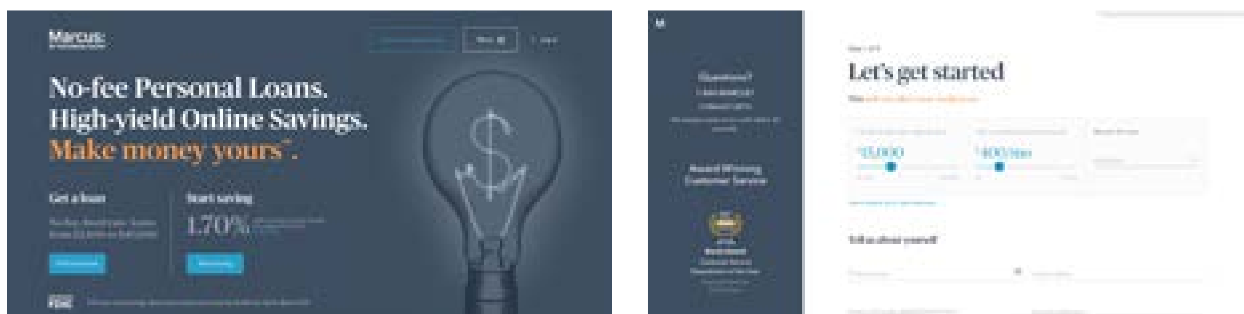
- >15%
- 12-15%
- 9-12%
- 6-9%
- 3-6%
- 0-3%



# How to Compete

The convenience and user experience offered in the digital space has led to 2.5 percent increase in premiums for those nontraditional firms. Current borrowers are no longer shopping interest rates, but instead “experience shopping,” and with only half of traditional bankers agreeing their industry is consumer centric this is problematic.

The best way banks have been able to compete with these disruptors is to beat them at their own game. Goldman Sachs released digital lending platform Marcus in 2016, giving users the ability to select fixed interest rates, monthly payment dates, and no extra fees. The success that Marcus has seen, along with Bank of America’s recent entry into the market serves as an excellent case study for those traditional banks looking to break into the market.




Screenshots of Marcus and it’s modern user interface.

To compete, banks need to take Goldman's lead and adopt a digital first mindset. This means controlling the online lending experience from first visit to funding. Modern software development practices, namely using APIs, allow lenders to create custom user experiences, while connecting to leading third-parties to process the data.

A custom online loan application ties the security and name of a traditional bank to the convenience of a digital method. Banks would be able to track data on where customers are hampered or drop out of the application process. Using this data banks could develop a real time understanding of their customer and tailor an experience to fit their needs. By using a targeted design borrowers could easily transmit soft information resulting in more effective screening or credit rationing.

By entering the digital space, community banks return the highest degree of integration and customer support. With non traditional lenders showing no signs of slowing down, it seems that the digital era of mortgage lending is here to stay.

## Next Steps

Now is the perfect time to enter the online lending market. It's never been easier for banks to develop their own online lending applications. LaunchPad Lab has helped financial services companies design industry leading solutions.

We'd love to talk through your company's digital transition. Contact us or schedule a 15 minute call for free below.

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Schedule a Call