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## Small Banks and FinTech: an Opportunity?

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Earlier this year BB&T and SunTrust announced a merger that if completed will create the sixth-largest bank in the United States.<sup>[1]</sup>

The press release announcing that merger includes the assertion that “Enhanced scale and financial strength will accelerate investment in transformative technology to embrace disruption . . .”

The implicit assumptions in that statement are: (i) banks must compete with FinTech companies for customers’ banking activities, and (ii) a bank must be large to invest in and benefit from FinTech advances.<sup>[2]</sup> Perhaps the newly merged bank will join other large banks that have chosen, at least in part, to battle FinTech by creating their own tech applications for traditional bank services – think the Zelle payment system which is owned by a group of eight large banks.

But, how should a community or regional bank react to the changes brought by FinTech that it does not own and control? The purpose of this blog post is to challenge the above assumptions by discussing two different approaches for banks that are not large enough to develop their own “transformative technology to embrace disruption”: (i) formal partnering with FinTech companies by assisting with the FinTech’s companies’ business activities; and (ii) recognizing that your customers are going to use FinTech offerings and integrating that fact into your bank’s business activities.

Certain small banks are having an outsized impact on the financial market by working with FinTech businesses to provide the regulated banking side of the business. One commentator described those small banks as “quietly run[ning] the plumbing underneath billion-dollar FinTech firms such as Square, Stripe, and Robinhood — handling mundane banking activities for them like holding customer deposits and underwriting loans — while the tech firms remake finance for a digital age. . . . ‘A few years back there was a lot of disruption talk about how the FinTechs were going to destroy the banks,’ said Jo Ann Barefoot, co-founder of Hummingbird Regtech

and a former deputy U.S. Comptroller of the Currency, which regulates national banks. 'There's much more talk in the last few years about the need to partner.'"[\[3\]](#)

Anecdotally, it seems that FinTech companies that are partnering with banks to help FinTech companies operate have generally chosen to cooperate with small banks who are thought to be more flexible and open to change. That cooperation might take the form of the regulated bank partner handling both: (i) bank-specific items like anti-money laundering rules; and (ii) mundane general money-related topics such as customer record keeping.

[This blog previously posted an article on the availability of Special Purpose National Bank charters for FinTech companies](#) so they can properly offer the part of their business that is a regulated "business of banking" activity. Partnering with a licensed entity that will handle the regulated activity may be an alternative to the SPNB charter and its complications; but, of course, it comes with a loss of control and potential profits for the FinTech company.

Recently, an employee of a regional bank (about \$2,500,000,000 in market capitalization) stated his belief that regional banks can use FinTech companies' offerings to help them compete with large money center banks. What he had in mind was a different form of partnering and cooperation between banks and FinTech companies. The key to this form of cooperation is the bank's willingness to recognize that its customers are going to use FinTech offerings and integrate that fact into the bank's operations and marketing.

Admitting this reality and accommodation of it would be contrary to traditional bank thinking: traditionally banks want their customers to carry and use the bank's own issued credit cards and debit cards – and, of course, banks love for a customer to have and use a checking account. Nearly every bank dreams of being a customer's exclusive home for money related activity and maybe it can convince customers not to have any other money-related relationship. Regardless of your hopes, your customers are going to use FinTech offerings. Not too long ago, those offerings resembled just a paper check [\[4\]](#) or debit card in the sense that they were money transfer devices; more recently tech companies have gotten closer to a bank's core business by offering a credit card that can

be the source of the funds for use with the tech company's transfer device – think the Apple credit card.

The question then becomes, how might a regional or small bank might message its business activities to attract customers who are using FinTech offerings? We propose that a bank should do the following three things:

First, the bank needs to admit that it cannot prevent this customer activity and so train its customer-facing employees (tellers, branch employees, phone center operators and loan officers) to accept and use the unavoidable reality. Do not just explain the low fees on your checking accounts – rather understand and explain how that checking account facilitates and enhances the benefits of a PayPal account;

Second, the bank must make sure the above marketing statement is true. If customers can arrange for automatic transfers between two accounts at your bank (such as a savings account and a checking account), it should be just as easy to arrange for that same transfer between the checking account at your bank and the FinTech money transfer app. Stated differently, why cannot a customer have checking account style overdraft protection for that customer's PayPal account which the customer also uses to pay her bills. This will require adaptation and change in the bank's systems which are usually constructed to encourage within-the-bank activities by making activities with outside accounts difficult; and

Third, the bank should use the customer's FinTech activity as part of your overall information gathering and relationship building activity. The best unique thing many banks offer is a human touch and there are always times when that is needed. Do not spoil that personal interaction by actually or implicitly denigrating your customer's decisions to use FinTech. For example, when a customer is seeking a loan, the customer should be able to provide the bank its previously completed FinTech automated loan application or records from a PayPal account instead of being told to complete a financial statement or your bank's specific loan application or create a cash ledger. The point is that cash on hand and vehicles owned are the same wherever they appear on whatever form and well-trained loan personnel (loan officers and credit officers) should be able to take

that information from whatever source and use it to make decisions.

FinTech is not going away. Smaller regional banks and community banks cannot create and control their own applications that compete with industry leaders. Those banks can, however, compliment their customer's FinTech use in a way that seamlessly (as much as regulators permit) give your customers access to the geographic and product scope that otherwise is available only at large banks and so reduce the competitive advantage enjoyed by those large banks.

Vince Mauer practices law in Ohio and Iowa for the law firm of Frost Brown Todd, LLC. He has an economics degree, a master's degree in Business Administration and passed the CPA exam. He has represented financial institutions in litigation matters for over 30 years. For more information on this topic, contact Vince Mauer at [vmauer@fbtlaw.com](mailto:vmauer@fbtlaw.com).

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[1] In 1990 the USA had over \$12,000 commercial banks. About 10-years ago, that number was down to around 17,000. Today, the number is about 4,700.

[2] A variation on the large bank model being used by some smaller banks is "a group of a dozen community and regional banks, with the help of consulting firm FinTech Forge, created a consortium that will work with financial technology startups to develop products and services that meet the digital needs of their customers." See, <https://www.forbes.com/sites/donnafuscaldo/2018/11/28/small-banks-join-forces-to-bring-fintech-to-customers/#20461dcf2647>. See also the business plan of the Alloy Labs Alliance.

[3] See <https://www.cnbc.com/2019/02/15/small-banks-youve-never-heard-of-quietly-power-the-booming-fintech-industry-.html> by Kate Rooney.

[4] Compare to a customer's ability to use Zelle or Venmo for P2P (person to person) money transfers or using a bank debit card to obtain and then carry cash.

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