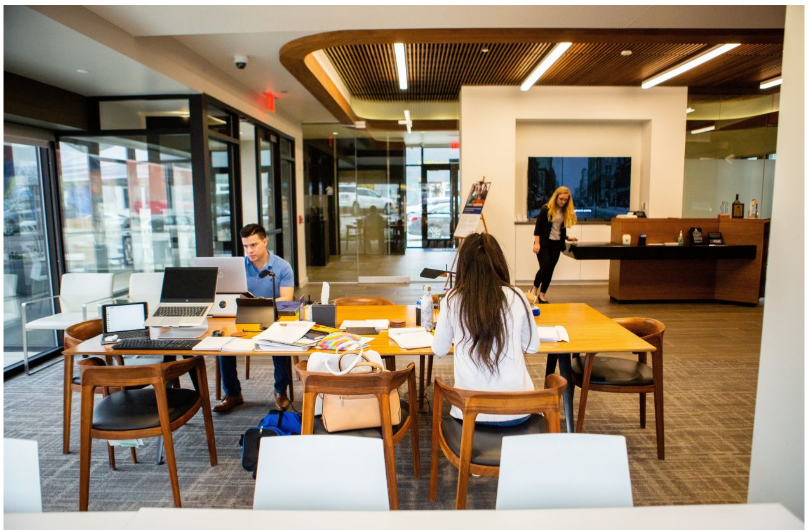
Small Banks Rebel Against the Most Important Tech Firms You Have Never Heard Of

Community lenders worry about losing customers to big rivals. They say their tech providers aren't always helping.



Lead Bank, a Kansas City, Mo.-based community lender, is trying different ways to attract customers through technology.PHOTO: KATIE CURRID FOR THE WALL STREET JOURNAL

By Telis Demos and Rachel Louise Ensign

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Lead Bank, a community lender in Kansas City, Mo., wanted to offer the payments app Zelle to its customers.

But it had a problem. A company called Fiserv Inc., FISV -1.68% which provides much of the bank's underlying technology, said Lead wouldn't be able to launch Zelle until June at the earliest. Big U.S. banks rolled out the service nearly two years ago.

Fiserv and two competitors— Fidelity National Information Services Inc., FIS -1.21% known as FIS, and Jack Henry & Associates Inc. JKHY 0.61% —are little known outside the banking world, but their infrastructure now makes up much of the modern banking system's financial plumbing, especially for smaller banks. They provide the technology behind everything from keeping track of customer deposits to powering mobile apps. As the number of community banks has shrunk, the three companies have grown, partly through acquisition of other tech providers, in both revenue and profit.

Lead Bank has videoconferencing tablets and digital whiteboards for customers to use and an ATM that dispenses $1 bills.PHOTO: KATIE CURRID FOR THE WALL STREET JOURNAL

These companies, known as "core providers," say they can affordably bring to small institutions big-bank technologies, including the newest tools such as open-data platforms and on-demand services.

But discontent is starting to simmer at the small banks that most depend on them. Smaller lenders and some industry groups say the service providers' onerous contracts and sometimes mediocre digital offerings have made it harder to keep up with big competitors. Executives at some small banks say they feel like they are becoming franchises of the core providers because they are so reliant on their technology. Firms are filing lawsuits, turning to financial-technology startups and trying to negotiate as a group for better contracts.

In an age of digital banking, having the right technology offerings can make the difference between gaining or losing a customer.PHOTO: KATIE CURRID FOR THE WALL STREET JOURNAL

"I've met with over 3,000 bank CEOs, and this came up time and again: the challenges and constraints they face with their core provider," said Rob Nichols, chief executive of the American Bankers Association, an industry group that represents large and small banks.

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As far back as the 1960s, companies like these started selling systems that helped banks computerize paperwork. More recently, smaller banks have turned to these companies for websites, apps and other tasks.

In an age of digital banking, having the right technology offerings can make the difference between gaining or losing a customer, and large banks with flashy apps are increasingly popular. Midsize and local banks hold 13% of primary banking relationships but capture only 7% of the customers who switch banks, according to consulting firm A.T. Kearney.

> The three biggest core providers today do business with 90% of U.S. banks with less than $1 billion in assets, according to financial-services research firm Celent.

They have become dominant through decades of consolidation, which has also broadened their focus beyond basic banking. FIS and Fiserv both said they would buy payments companies in two of the largest mergers and acquisitions transactions so far this year. Jack Henry is the smallest of the three companies by revenue and many of its clients are credit unions.

Some are trying to shake this up, including banks' main trade association. The ABA in January said it took the unusual step of investing directly in a startup called Finxact, which was founded by a veteran of the core-provider business. Among its features is that it is offered as a recurring subscription, rather than a multiyear contract.

> Another sticking point for smaller banks is the hefty fees embedded in the firms' long-term contracts.

Millington Bank, a New Jersey community lender, recently discovered that it would owe FIS more than $4 million if it sold itself, according to court documents. That is nearly an entire year of profits for the bank. The bank sued FIS. In March, the case was "stayed pending arbitration," according to a court filing.

Another community lender, Iowa Falls State Bank, sued Jack Henry in 2017, alleging the provider charged roughly $137,000—nearly 10% of the bank's annual profit—for access to the bank's own data as part of the bank's discussions with a new vendor, according to court filings. In the suit, the bank described Jack Henry as "essentially holding [our] information for ransom." Jack Henry in a court filing denied the allegations, citing the bank's agreements with the firm. The lawsuit is ongoing.

"They're not building highways to the banks' data, they're building toll roads," said Aaron Silva, whose firm Paladin fs negotiates contracts with the companies on behalf of the banks. Mr. Silva has assembled dozens of banks into a coalition to negotiate as a group for better deals.

Core providers say long-term contracts can give small banks assurance that their providers will continue to support them. They also say fees reflect the level of investment into services and new products.

Virginia-based Union Bank and Trust recently built its own data warehouse that keeps a copy of all the information stored by its core processor FIS, the bank's Chief Information Officer Dean Brown said. That was difficult and expensive, but allowed the bank to develop its own tool for customers depositing checks from smartphones that has flexible limits.

"Once you've decided to join with a core, you're resigned to the fact that you're a fast follower," Mr. Brown said. Despite that, "we have a good relationship."

FIS said a bank's data ultimately belongs to the bank. The company recently launched a portal, called Code Connect, for banks to make their data available to other parties that can develop tools for banks.

Lead Bank, the Kansas City lender that is still waiting to offer Zelle, is trying different ways to attract customers through technology. For example, it is partnering with startup Self Lender Inc., which provides specialized loans to people with little credit history. It has also worked with Fiserv on adopting other digital tools.

Fiserv said it has updated its process to roll out Zelle to many banks at a time, and has hired more people to help support that effort across thousands of financial institutions.

Lead Bank's CEO Josh Rowland said community lenders "are fighting a Walmart -sized battle" to keep up with big banks.

"We're not going to wait around," Mr. Rowland said, "but it's harder than it feels like it should be."

Lead Bank CEO Josh Rowland said community lenders ‘are fighting a Walmart-sized battle’ to keep up with big banks. PHOTO:KATIE CURRID FOR THE WALL STREET JOURNAL

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