



The Oklahoma Project

As seen in the 4th Quarter 2020 issue of *Bank Director*



A small bank in Oklahoma is betting it all on the digital banking revolution.

Driving on the open, flat highways in Oklahoma can play tricks on your sense of time. The scenery mostly looks the same, so it feels like you're going nowhere fast. But then, you look down and suddenly realize you're pushing 90 miles an hour. I can't help but wonder if that same feeling — moving gradually, then all at once — is one that stakeholders of Stride Bank can relate to. For years, the Enid, Oklahoma-based institution operated like your typical community bank, growing at a slow and steady pace. But then Stride looked down and realized it was topping out the speedometer, vacuuming up deposits so quickly that it nearly doubled in size in the first half of 2020.

Stride finished last year with \$699 million in total assets. That climbed by \$100 million through the first quarter of this year and another \$400 million by the end of the second quarter. Meanwhile, the bank's ACH transaction volume exploded. By the end of 2019, Stride was processing 26,000 transactions per month for a total volume of \$2.9 million. Today, it's processing 2.5 million transactions per month, equal to \$1.5 billion in total volume.

Powering this growth is Stride's partnership with Chime, a digital-only challenger bank with 4.3 million customers who consider it their primary bank — ostensibly ranking Chime 10th in primary-bank relationships among all banks. The partnership is the culmination of decades of work at Stride to prepare for this moment. But now that the moment has arrived, the question is how Stride will navigate it in an industry where hypergrowth often ends in ignominy.

R.S. "Brud" Baker is not one to shy away from a challenge. The 50-year Stride veteran serves as its chairman and CEO. Everything he's done over the last two decades has been building up to this.

Stride began life in 1913 as the Central National Bank of Enid. One hundred and six years later, in 2019, it changed its name to Stride Bank. It did so to better align with its new tech-forward clientele. Beneath its quaint exterior, Baker has been meticulously building out a payments division with a full compliance team and connections to eight payment processing networks. By 2020, the bank had more prospects in its pipeline than it could shake a stick at. The last several years have been a wild ride for Stride, but everyone there will tell you that it's all a part of Baker's vision.

Baker is embarrassed when we sit down for our last interview at his office in Tulsa over the summer. He doesn't like being the center of attention, so the fact that everyone I've interviewed describes him as a "visionary" makes him cringe. To Baker, the vision for the bank that he and his right-hand man, Dennis Gerhard, Stride's chief operating officer, started sketching out years ago was simple.

On a flight home from Miami in the late nineties, Baker and Gerhard were discussing interconnectivity. They could sense something big was coming as a result of the internet. They reasoned it would be the erosion of the traditional, geographic lines that had defined financial services since time immemorial. Without geography to hem banks in, the opportunities for diversifying a bank's business would proliferate.

Baker and Gerhard knew one of their most valuable assets was access to the payment rails, the technological infrastructure underlying the movement of money. Could they lever-



BY AMBER BUKER

THE OKLAHOMA PROJECT

age their position as a switch operator, Baker and Gerhard wondered, to help nonbanks deliver financial services? Thus was born the vision for Stride's future.

The key to Stride's evolution would lie in gradually growing its core commercial banking operations and then using those earnings to swing for the fences with new business lines, like payments, that benefited most from economies of scale.

"The idea was a pretty simple banking idea," Baker says. "Don't get paid very much per click but get a whole lot of clicks." That mentality quickly took root in Enid, and the hundred-year-old institution began its slow metamorphosis into a modern platform bank.

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Over the years, Stride built up its repertoire in processing, payments and platform banking with everyone from big box retailers to Native American tribes. By 2020, it was poised for its modern debut. The bank began issuing Chime debit accounts in December 2019, just as the U.S. began hearing about a novel coronavirus outbreak in China. Stride planned to make half its income from program fees paid by Chime and half from interest income on the deposits it would hold for the digital-only bank. But that model couldn't account for the effects Covid-19 would have on the economy once it took hold in the U.S.

As bank lobbies closed and the government doled out CARES Act stimulus checks, millions of people turned to Chime to access their funds. Chime not only promised to get customers their money up to two days faster than other banks, it actually offered to spot people a few hundred dollars to cover their expenses in the meantime. That ethos helped the challenger bank grow from 1 million users in 2018 to over 8 million users by mid-February 2020.

As Chime was exploding, Shelly Connolly was trying to figure out how to keep hiring with the nation on lockdown. Seeing the rapid growth of

the payments division and the need to support an almost entirely remote workforce, Stride's director of human resources knew that the process of onboarding new hires couldn't wait for a vaccine.

One new hire, who interviewed over the phone during the pandemic, met his new boss, Michael Carr, director of information services, in a scene that looked more like a back-alley deal than an official onboarding session. "They met in the parking lot," Connolly laughs. "I know that sounds so shady!"

As each new hire joined, they'd pull up in Stride's parking lot, open their trunk and wait for Carr to load them up with hardware. They did this for three weeks, bringing on seven new employees while everyone worked from home. Between January and August, Stride filled 25 new positions, a significant number for a bank with a prior headcount of 180.

Amidst this rapid expansion, a countervailing force threw a wrench in Stride's carefully laid growth plan: While its deposits were skyrocketing, interest rates were plummeting.

When Stride put together the deal to serve as the issuing bank for Chime last year, the federal funds rate was around 2%. But by the time Stride added its first \$100 million in new deposits from Chime, it was earning just 10 basis points on the funds. This matters for all banks but especially for Stride, which has stashed virtually all its new deposits at the Federal Reserve. It's a prudent move, to be sure, but it caused Stride's loan-to-deposit ratio to fall off a cliff — followed by its net interest margin. "Half the income is just not there," Baker says. "But it is what it is. I can't fix that."

As far as Baker was concerned, everything was going, more or less, according to plan. The bank knew it would absorb a torrent of new deposits when Chime went live, even if the incredible growth — spurred by the CARES Act stimulus checks — wasn't entirely foreseen. And Stride knew that it would need to keep those funds liquid until it learned how sticky they were, even if that meant earning next to nothing on them while parked at the Fed — making those funds, at least for now, more of a risk than a reward. "It does slow down our increase in terms of capital," Baker admits. "That was the biggest blip in the whole plan."

Chasing down audacious, new opportunities is in Baker's blood. In a glass-walled corner office at Stride Bank in Tulsa, his son, Adam Baker, gets a twinkle in his eye when he starts talking about the Baker family lore.

The younger Baker's grandfather, R.S. Baker Sr., was born in Ponca City, Oklahoma, in 1902. He

worked for the Marland Oil Co., which was founded in 1917 and within three years was producing an estimated 10% of the world's oil. Despite this success, Marland was continually strapped for cash. The company turned to investment bank J.P. Morgan & Co. to help finance its expansion, but by 1928 the founder, E.W. Marland, was forced out of his company by the bankers. "When Marland got taken over by J.P. Morgan, Papa got pissed," says Adam Baker. So in 1930, the family patriarch headed to Texas to become a wildcatter.

A year later, Baker's group struck oil. Their well, No. 1 Lathrop, was purportedly the site that confirmed the existence of the East Texas Oil Field — a lucrative gusher of black gold that covered 140,000 acres of land and would go on to host over 30,000 oil wells. "Right out of the gate, he went from dead broke to doing well in the heart of the depression," Adam Baker says. A grainy, black and white photo of the well hangs in Brud Baker's office today.

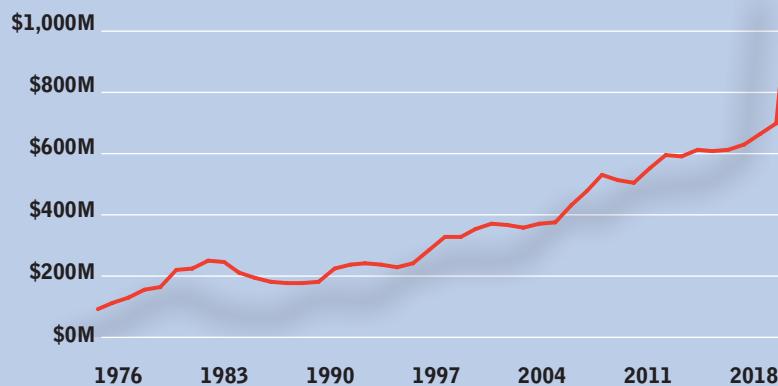
The Bakers' colorful history didn't stop with R.S. Baker Sr. After studying at the University of Colorado, Brud Baker spent a year "bumming around Europe" — a child of the sixties. Eventually, he came back to the States and earned his master's degree in international business. That, combined with the fact that he was deemed ineligible to serve in Vietnam due to a bad knee, made Baker an attractive candidate in the job market. But one theme resurfaced over and over again in his interviews. "I remember [people] telling me they rarely hire somebody from Oklahoma, because they always go back," he says. They were right.

After working for Citibank in Brazil, Baker made his way back home. "A banker from my hometown hollered and said, 'Hey, we really need somebody,'" he recalls. "So I came."

Baker joined the former Central National Bank of Enid in 1970. Not long after Baker's return, Dennis Gerhard joined the bank as a night computer operator. Gerhard has a broad smile and walks at a jaunty pace; the team at Stride loves to tease him about having been with the bank since its doors opened in 1913. A native Oklahoman, Gerhard understands the impact that the Central National Bank had on the region.

"Enid is a unique town that no one really appreciated," he says. The 74-square mile area is the birthplace of companies like Union Equity, one of the largest grain storage operations in the country; Groendyke Transport, which claims to be the fifth largest tank-truck carrier in the U.S.; and the George E. Failing Co., whose famous portable drills were used in World War II to secure water supplies for the troops.

Stride Bank Total Assets



Stride Bank Loan-to-Deposit Ratio



Stride Bank Balance Sheet Composition



Source: FDIC

Enid's robust economy in the 1970s provided the perfect opportunity for the bank to cut its teeth on international payments, exports and treasury management services, handling all its own wires and ACH transfers in-house. "Even though we were a small bank, we supported a lot of industries," Gerhard says. "So we evolved by offering services a lot of large banks do because of where we were sitting."

As time marched on, local business stalwarts were sold and resold, various companies' headquarters abandoned Enid, and the flow of new talent to the area slowed. Then the bottom fell out of the Oklahoma banking industry with the failure of Penn Square Bank. The now-infamous Oklahoma City-based lender made too many risky energy loans and failed in 1982. The collapse reverberated throughout the industry, setting in motion the failure two years later of Continental Illinois National Bank and Trust Co. of Chicago, the seventh-largest bank in the country at the time, and leading to 112 commercial bank failures in Oklahoma alone throughout the remainder of the decade.

Stride narrowly escaped that fate. Its loan portfolio shrunk by two-thirds within six months, and the bank had to lay off a third of its employees. "We were hardcore," Baker remembers. "There wasn't anything nice about it, but we had a job and that was to keep the bank alive, and nothing else mattered."

The hit from Penn Square wasn't the only blow for the bank around that time. Stride was also embattled in a securities lawsuit and a failed merger in the mid-1980s. "It really is hard to appreciate how crazy that time was," Baker says. "But we all came out of it and we built a hell of a trust."

That trust laid the foundation for the progressive approach to diversification that Baker and Gerhard envisioned for the bank. By the early 1990s, Baker had taken on the role of president and CEO, and he and Gerhard were ready to cut a new path to profitability.

Stride took its first shot by operating ATMs for other banks. At one point, Gerhard remembers, "just about every ATM going down Highway 81 in Oklahoma, we ran." Eventually, that technology became more ubiquitous and Stride got out of the ATM business. But this pit stop on the bank's journey helped mold its approach to compliance and program management.

Later, Stride partnered with a technology firm to build a debit card network that could support the large-scale issuance and in-house processing of prepaid cards. It was the early 2000s, and the financial industry was scrambling to get a handle on what rules and regulations governed stored-value cards. The PULSE payments network that Stride worked with in Houston didn't allow prepaid issuance, so it was up to the bank's compliance experts to help PULSE navigate the regulatory landscape.

The team at Stride was militant about compliance. The bank understood that it had to be far above-board in order to keep pushing the envelope of its business model. A common joke around the office at the time was that it was everyone's job to "keep Brud from going to jail." While said in jest, the quip belied the fact that Stride's compliance culture was at the forefront of everything it did.

Stride's prepaid offerings took off in earnest in 2007, with the bank issuing everything from gift cards to payroll cards for other financial institu-

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R.S. "Brud" Baker, chairman and CEO at Stride Bank



tions. The business produced the bank's first major jump in assets in decades — moving it from \$372 million in March 2006 to just under \$530 million by the end of 2008. The program grew rapidly, testing the bank's bandwidth and appetite for burning capital. When Gerhard had to hire a database manager from NASA to keep apace, he and Baker knew it was time to get out of the prepaid processing business.

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Stride weathered the Great Recession, experiencing intermittent progress and setbacks. After the crisis, it began growing loans again — at a rate of about \$30 million per year from 2012 onward. It also started to zero in on a new business model: providing the infrastructure and oversight to allow nonbanks to deliver financial services to the mass consumer market. Then, the bank made a key hire that would catapult it into a new stratosphere of expansion.

When I mentioned to folks at Stride that I had interviewed Mark Sumby, its business development guru, they all reacted with some version of, "Oh, gosh, what did he say?" Sumby is a bit of a wildcard. The first time he went to a conference representing Stride, he hired a pair of leggy models to walk the trade show floor and hand out his business cards. To this day, he says, people still talk about it.

The native New Zealander knows how to make an impression, and it's served him well at Stride. Early on, Sumby brought on large firms like Automatic Data Processing, commonly called ADP, Sodexo and Uber Technologies. Then he upped the ante. In 2018, Stride won a key relationship with Chime and signed on to issue the challenger bank's debit accounts and "Credit Builder" secured cards. It was a huge coup but, as Stride tells the story, it just came down to relationships, the promise of white-glove service and the ability to get Baker on the phone any time it was needed.

Shortly after closing Chime, Stride announced

that it would issue the commercial debit accounts and cards for Lyft rideshare drivers receiving instant payouts. The announcement came days before Lyft went public, hitting just over \$87 per share in its March 2019 IPO. In the coming months, Stride expects to announce more marquee deals, with at least one other company on the verge of going public.

Sumby credits Baker and Gerhard with shaping the vision for Stride. "What we all said would happen, happened," he says. As commercial loan origination and branch traffic slowed down, payments continued to grow at incredible speeds. "The board sees that now," Sumby says. "They drank the Kool-Aid for years, but now they're drinking champagne."

The days of champagne have been a long time coming for Stride's board. "Brud's had this game plan for 10 years, and it didn't come free," says Rance Pappan, Stride's chief financial officer. The bank's efficiency ratio has been lodged around 75% for much of the last decade due to its investments in payments infrastructure, compliance tools and personnel. As Baker points out, "how many banks that are, at their core, \$600 million [in assets] have nine people in their anti-money laundering group" and a general counsel? The rebranding effort — a process spanning several years — as well as the new location in Oklahoma City have also come at considerable expense.

Stride's payments business has consistently been profitable, but the overall result for the bank has been middle-of-the-fairway earnings. Still, the bank's board has stuck with Brud. "We hit singles and doubles back then, but nothing to the scale of what we're doing now," Pappan says. The board has "been accommodating and has given [Brud] a pretty long leash to pull it off," Pappan continues. "They're excited at this point, but they had to have a lot of trust in him to go that long."

Today, that trust is paying off. Baker anticipates the bank's earnings will be significantly higher this year as a result of fee income. Chime alone provides the bank with hundreds of thousands of dollars in added noninterest income each month.

Still, the \$500 million question lingers: What will Stride do to capitalize on all the deposits it's amassed?

Right now, the bank is playing it safe. It's assuaging regulators by stowing the cash at the Fed. And it's politely declining offers from investment bankers looking to put the funds to work. To emphasize this point, by the end of July, Stride's loan portfolio was down \$40 million from the start of the year. The bank has been emphatic about not wanting to make risky loans with the excess liquid-

ity. And Baker turns down acquisition suitors left and right. "Nobody's going to pay me what I think our future is [worth]," he says. "Nobody would have paid me for this two years ago."

Stride, along with the rest of the world, appears to be in a Covid-19 holding pattern. The unknown unknowns are just too numerous and significant for the bank to make the kinds of big moves it needs to take advantage of its newfound wealth in the form of deposits.

To a great degree, Baker says, the model for Chime was always based on staying highly liquid until the bank could identify and reasonably predict the new account flows. But "it would have been a lot easier if Covid hadn't come and interest rates hadn't gone to zero," he acknowledges. A major benefit from the Chime relationship was supposed to be access to free deposits. But now the bank has to manage its capital ratios while simultaneously keeping adequate liquidity on hand to support Chime's customers' needs.

"We have to walk cautiously," says Kevin Guarnera, a longtime lender and the new market president for Stride in Oklahoma City. "We can't be silly just because we have a war chest."

Guarnera is one of the people responsible for growing the bank's lending business from its new offices in Oklahoma City, but he hasn't felt pressure to put the bank's new funds to work right away. He's hopeful that once things stabilize, Stride will be perfectly positioned to help rebuild the economy. "We think it's going to make us highly competitive," he says. "We'll have deposits we can utilize that a lot of our competition don't have at the cost basis we have it at."

In August, Baker estimated that current interest rates are costing the bank between \$10 million and \$12 million a year in lost opportunity costs.

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Still, Stride would rather be safe than sorry on the liquidity front, and it would rather be early than late when it comes to seizing opportunities like the one with Chime. They say it's all in the timing. Everyone loves a big, automatic win. But Baker's goal is to make sure the bank gets to keep playing the game.

"We don't worry about next quarter's earnings. We never have. It's just not who we are," Baker says matter-of-factly. "There are plenty of reasons to suggest I should take this bank public, but nobody wants to do it because it'll change the way you manage." He continues, "if I start managing to next quarter, we won't be able to do the stuff we do."

Baker would rather reduce earnings today by hiring the talent or buying the technology the bank needs to do even bigger things tomorrow. He is always thinking about the future. Even as his team works to get a handle on its current success, Stride already has its eyes trained on the next frontier — which mostly consists of payment opportunities that have unlimited upside in terms of fee income and relatively little impact on the bank's balance sheet.

It would be easy to dismiss Stride's appetite for innovation as venture tourism. Baker himself jokes that the bank is where it is today because he has a "low boredom threshold." But stark truths undergird his motivations. "Change is inevitable; change is fun," he says. "Disruption is threatening — and still intellectually challenging. And I wanted this bank to survive." Being the leader of an innovative bank means "you're constantly rethinking and tinkering with who you are," Baker says. "It's just the only way to do it."

As uncomfortable as it is for leaders to test the limits of what it means to be a bank, it's never been more important to do so. Covid-19 has thrown this reality into sharp relief. Research from Cornerstone Advisors in July 2020 revealed that the number of U.S. adults that consider a digital bank to be their primary checking account custodian rose by 67% in the first two quarters of 2020. About half of Chime's 8 million users are counted among them, putting the challenger bank in the same league as institutions like Citigroup and USAA.

It's hard to predict the future of a gutsy institution like Stride. This latest experiment in its long history of evolution might be brilliant, or it might be bonkers. Only time will tell. But one thing is for sure — this small-town Oklahoma bank isn't standing still. **|BD|**

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