

Internet Banks: Pros and Cons

How Online-Only Banks Stack up Against Traditional Institutions

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Figuring out where to bank starts with a decision about the type of institution you want. Do you prefer a bank with brick-and-mortar branches and its own automated teller machines (ATMs) or an online-only alternative that gives you a purely online or mobile banking experience?

Traditional and online banks—also known as direct banks—both offer you access to your account online, and the ability to transfer money or perform other tasks with a few clicks of your cursor or taps on your phone screen. They're both subject to the same laws and regulations—online-only accounts are guaranteed by the Federal Deposit Insurance Corporation (FDIC) just like the accounts held at traditional banks. Security is the same overall, with both types employing such measures as encryption to protect your funds and identity.

But even if both types have become close cousins in some ways, important distinctions remain. Direct banks leverage their lower costs to offer better interest rates and, often, lower fees. Brick-and-mortar institutions offer a convenient array of options for deposits and other transactions including offering the option for face-to-face service at a bank branch when you need it. If you're on the fence about internet banks, this article may help you. It outlines the main pros and cons of this part of the banking industry.

KEY TAKEAWAYS

- Before choosing an online bank, it's important to decide what features are most important to you.
- The lack of overhead gives internet banks advantages over traditional banks, including fewer or lower fees and accounts with higher APYs.
- Internet banks lack personal relationships, no proprietary ATMs, and more limited services.

Online Banking: A Quick History

As the commercialization of the internet evolved in the early 1990s, traditional brick-and-mortar banks began looking for ways to deliver online services to their customers. Though limited at

first, the success of these early efforts led many banks to expand their internet presence through improved websites featuring the ability to open new accounts, download forms, and process loan applications.

This led to the birth and rise of internet-only banks. These institutions offer online banking and other financial services without a network of branch offices. The first fully-functional direct bank insured by the FDIC was the Security First Network Bank, which began operations on Oct. 18, 1995. Security First and those that followed were able to offer higher interest rates on deposit accounts and reduced service fees all because of the lower costs due to a lack of overhead.

As the choice in virtual banks grew, so did customers' enthusiasm for banking online. More than 60% of account holders do at least some of their banking on the internet, according to the latest report on banking behavior from the FDIC.

Pros of Internet Banks

Despite the rising virtual presence of traditional banks, online-only competitors still offer some clear advantages for consumers.

Better Rates, Lower Fees

The lack of significant infrastructure and overhead costs allow direct banks to pay higher interest rates or annual percentage yields (APYs) on savings. The most generous of them offer as much as 1% to 2% more than you'll earn on accounts at a traditional bank—a gap that can really add up with a high balance. While some direct banks with especially generous APYs offer only savings accounts, most of them offer other options including high-yield savings accounts, certificates of deposit (CDs), and no-penalty CDs for early withdrawal.

You're less likely to be dinged with a wide range of fees at a direct bank including those associated with keeping an account open with a low balance, making direct deposits, or paying by check or debit card. Accounts at direct banks are more likely to carry no minimum balance or service fees.

Better Online Experiences

Traditional banks are investing heavily in improving their virtual presence and service, including launching apps and upgrading websites. But overall, direct banks appear to retain an edge when it comes to the online banking experience.

A 2018 Bain and Company survey of retail banking customers found traditional banks lagged behind direct banks in the areas that mattered most to customers, including the quality of the banking experience and the speed and simplicity of transactions.

1% to 2%

The gap between the interest rates earned by accounts in traditional banks and internet-only banks.

Cons of Internet Banks

Banking with an online institution also has its share of drawbacks and inconveniences.

No Personal Relationships

A traditional bank provides the opportunity to get to know the staff at your local branch. That can be an advantage if and when you need additional financial services, such as a loan, or when you have to make changes to your banking arrangements. A bank manager usually has some discretion in changing the terms of your account if your personal circumstances change, or in reversing a mandatory fee or service charge.

Less Flexibility With Transactions

In-person contact with a banking staffer isn't only about getting to know you and your finances. For some transactions and problems, it's invaluable to head to a bank branch.

Take, for example, depositing funds—the most basic of banking transactions. Depositing a check is possible with a direct bank by using its banking app to capture both the front and back of the check. However, depositing cash is downright cumbersome at many online banks. So, it's worth checking the bank's policy if this is something you plan to do frequently. International transactions may also be more difficult, or even impossible, with some direct banks.

The Absence of Their Own ATMs

Since they lack their own banking machines, online banks rely on having customers use one or more ATM networks such as those from AllPoint and Cirrus. While these systems offer access to tens of thousands of machines across the country—even around the world—it's worth checking the available machines near where you live and work.

Check, too, for any fees you may rack up for ATM use. While many direct banks offer free access to network ATMs or will refund any monthly charges you incur, there are sometimes limits on the number of free ATM transactions you can make in a given month.

More Limited Services

Some direct banks may not offer all the comprehensive financial services that traditional banks offer, such as insurance and brokerage accounts. Traditional banks sometimes offer special services to loyal customers, such as preferred rates and investment advice at no extra charge. In addition, routine services such as notarization and bank signature guarantee are not available online. These services are required for many financial and legal transactions.

The Bottom Line

Traditional and online-only banks both have their advantages. Basically, you have to decide whether a brick-and-mortar institution's services and personal touch outweigh the often higher costs, in terms of lower interest rates and more numerous fees, of banking there.

It's also worth considering dividing your business between one of each. True, this arrangement may not be practical for you, and the fees for holding multiple accounts may be an issue. But having accounts at both a traditional bank and an online bank can facilitate the best of both worlds—higher interest rates, along with access to in-person help with transactions and problems when you need it.

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