

7<sup>th</sup> Annual Legal, Regulatory and Compliance Forum on

# FINTECH & EMERGING PAYMENT SYSTEMS

## Bank and FinTech Partnerships Today: Are the Banks Catching Up? What Can Fintechs Offer Today to Stay Competitive?



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# ...Are the Banks Catching Up?

Short answer: Maybe (not)

Is this the right question?

Bank partnerships provide more optimal solutions by allowing each party to focus on its core competencies

**Banks:** Regulatory compliance and oversight – products, people, infrastructure (including insourced from third parties); experienced lenders

**Fintechs:** Technology (reach, speed & scale), CX/UX, onboarding, servicing, marketing, distribution and access channels

## ... What can Fintechs Offer to Remain Competitive?

### **Remind me – who needs to remain competitive?**

- Large bank innovation is not an oxymoron – but still often [usually?] fueled by Fintechs
  - Evolution in large technology partners to be more “fit for purpose” as bank partners
- Fintech-enabling banks continue to proliferate
- BaaS platform providers continue to proliferate
- Shift in money transfer volume/licensing to Fintechs ([csbs.org](https://www.csbs.org))

## ... What can Fintechs Offer to Remain Competitive?

### **But there are major challenges for Fintechs...**

- BaaS under pressure - OCC likens “de-integration” in banking to “shadow banking” and causes of 2008 financial crisis (Michael Hsu speech Sept. 7, 2022)
- Expansive regulatory and aggressive [anti-business?] enforcement environment
  - “Junk fee” “whole of government” initiative, CFPB credit card late fee proposed rule
- Oh, and also: funding environment has changed -
  - Access, valuations, cost of funds, desirability / affordability of products  
<https://carta.com/blog/fintech-funding-falls/>

# ... What can Fintechs Offer to Remain Competitive?

## And challenges for Banks and Fintechs to address together

### *Madden*-like challenges v. “Valid When Made”

- OCC’s final rule amended 12 CFR 7.4001 and 12 CFR 160.110 by adding a new section, stating: “Interest on a loan that is permissible under [12 USC 85 and 12 USC 1463(g)(1), respectively] shall not be affected by the sale, assignment, or other transfer of the loan.”
- FDIC’s final rule amended 12 CFR Part 331, providing in section 331.4(e) that: “Whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act is determined as of the date the loan was made” and “shall not be affected by... the sale, assignment, or other transfer of the loan, in whole or in part.”
- Multiple State AGs filed District Court actions challenging both rules, their motions for s/j were denied and not appealed

### Repeal of the OCC True Lender Rule pursuant to the Congressional Review Act

### Ongoing “true lender” / “rent-a-charter” challenges

- State AG enforcement actions
- Unclear legal standards: totality of circumstances v. predominant economic interest

Other state issues: licensing and new predatory loan prevention acts with broad anti-evasion provisions (and PEI tests)

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Proposed Guidance for Third-Party Lending: FIL-50-2016 <https://tinyurl.com/2n3nu257>

- Due diligence in the selection and vetting of fintech partners
- Risk assessments of fintech partners upfront and on an ongoing basis
- Carefully structured agreements to ensure the Bank has the authority and rights it needs over programs supported by fintech partners and to limit the Bank's exposure
- Ongoing supervision and oversight across all aspects of programs supported by fintech partners.

Proposed Interagency Guidance on Third-Party Relationships: Risk Management: FIL-50-2021 <https://tinyurl.com/47czer9s> (would replace the FDIC's Guidance for Managing Third-Party Risk and the FDIC would rescind FIL 44-2008)

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Comply with all consumer protection laws and regulations, including TILA/Reg. Z, ECOA/Reg. B, EFTA, FCRA, FCBA, FDCPA, FTC Act §5, and the UDAAP prohibition under the Dodd-Frank Act §1036, as applicable

Ensure products are non-predatory

- FDIC's Supervisory Policy on Predatory Lending (FIL-6-2007)
- FDIC's Expanded Examination Guidance for Subprime Lending Programs (FIL-9-2001)
- Interagency Lending Principles for Offering Responsible Small-Dollar Loans (May 2020)

# ... What can Fintechs Offer to Remain Competitive?

## And challenges for Banks and Fintechs to address together

When Banks provide the products/services, there should be no question about whether products/programs are within the “regulatory perimeter”

- Under the **Bank Service Company Act**, 12 U.S.C. § 1867(c), the FDIC may examine the Bank’s service providers to the same extent as the FDIC examines the Bank

But the Bank must control the program and subject the partner to meaningful **oversight**

- Agreement by and between Blue Ridge Bank and OCC: <https://tinyurl.com/585avyr5>
- Select Subcommittee on the Coronavirus Crisis - “We are not the Fraud Police”: How Fintechs Facilitated Fraud in the Paycheck Protection Program (Staff Report December 2022)
- Did FinTech Lenders Facilitate PPP Fraud? John M. Griffin, Samuel Kruger, and Prateek Mahajan, McCombs School of Business, University of Texas at Austin [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3906395](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3906395)
- FDIC downgrades TAB Bank CRA rating to “needs to improve” on most recent CRA exam. <https://tinyurl.com/5bnvz>

**Critical:** cultural alignment between the Bank and the fintech regarding what it takes to support an effective and compliant bank partnership



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### Program Agreements – Key principles – example of a loan program

- 1 The Bank has ultimate approval authority over all services provided to it by the fintech partner, including w/r/t marketing content, onboarding flows and disclosures, customer-facing materials, servicing standards and procedures, and rights to oversee all aspects of the program
- 2 The Bank controls all terms of credit related to its loan program provided through the fintech, has the absolute right to approve, deny, or modify the credit policy determining whether credit is extended and under what terms, and exercises oversight over any credit models, including governance of credit models under applicable model risk management requirements
- 3 The Bank has authority to require the fintech partner to implement and revise policies and procedures related to the Bank's loan program, including w/r/t the Compliance Management System (including BSA/AML/OFAC), Complaint Management System, Third-Party Risk Management Program, Information Security, Red Flags, etc.

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### Program Agreements – key principles (cont'd)

- 4 The fintech provides regular reporting, monitoring & testing, and the Bank is entitled to audit the partner on a regular basis (quarterly, annually) and as needed, directly and through independent third-parties w/r/t all aspects of the Bank's loan program (CMS, IT, etc.)
- 5 The Bank's loan program is subject to oversight by the Bank's state and federal prudential regulators and the fintech will provide the Bank's regulators with access to examine, review, and audit the fintech as the regulators determine in their discretion

# ... What can Fintechs Offer to Remain Competitive?

## The best approach still – a strong bank-fintech collaboration

### Appreciating full scope of third-party risk management – and the options

- 1 Requires bank to understand the fintech offering and the fintech to appreciate the regulatory expectations
- 2 Understand impact of other key guidance
  - FFIEC Joint Statement “Security in a Cloud Computing Environment” (Apr. 30. 2020)
  - FDIC Supervisory Guidance on Model Risk Management, FIL-22-2017
- 3 Ultimate reward – Program Agreement that is “fit for purpose”

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**The best approach still – a strong bank-fintech collaboration**

## **Success factors:**

- 1** Mutual awareness of “regulatory perimeter” and setting boundaries to recognize respective bank – fintech roles
- 2** Take time / apply talent to evaluate the full impact of a relationship on each partner
  - Tailor agreement to the circumstance – payments, lending, deposits – and the roles of the parties
  - Challenging in a turbulent, innovative environment

# ... What can Fintechs Offer to Remain Competitive?

## Fintech Opportunities

Perception of bank instability and fallout from crypto winter

Higher level of remote customer engagement with financial services

Greater availability of engineering talent(?)

Scrutiny of Big Tech (anti-trust, data collection and use)

Oh, and funding environment has changed...Look for B2B, subscription models, profitability back in favor

Pending CFPB Section 1033 rulemaking on consumer access to electronic financial records – US does “open banking”?



HAVE A QUESTION?



# Q&A