



Where Business & Law Intersect SM

FinTechs and Community Banking – How are Banks Successfully Partnering With FinTechs and What are the Challenges and Opportunities?

Saltmarsh Executive Forum

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Overview

- What does FinTech mean?
- Who are the prominent FinTech companies?
- What changes are FinTech companies causing?
- How do banks partner with FinTech companies?
- What should banks be aware of when considering such partnerships?



What Does FinTech Mean?

- Financial Technology

- “Fintech is a broad term, but at its core, it refers to the use of technology to better deliver banking products and services. These services could be in the form of lending platforms, payment processes, investments and savings, blockchains, digital currencies, or a host of other areas.”

- Source: Teresa Curran, View from the District: Fintech: Balancing the Promise and Risks of Innovation (www.communitybankingconnections.org/articles/2017/i1/fintech)(visited 9/15/2018)



What Does FinTech Mean?

- Financial Technology
 - Structural focus on technology first, financial services second
 - Automation over workforce
 - Artificial intelligence / machine learning
 - Online delivery
 - Data driven



Prominent FinTech Models

- Lending
- Investing / personal finance
- Payments
- Blockchain
- Insurance
- Banking

THE FINTECH ECOSYSTEM

ROBO-ADVISORS & PERSONAL FINANCE



BLOCKCHAIN & BITCOIN



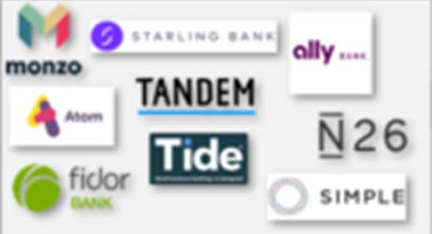
INSURTECHS



REGTECHS



DIGITAL BANKS



ALTERNATIVE FINANCE



PAYMENTS & REMITTANCES



BI INTELLIGENCE

Source: Company websites, BI Intelligence



Examples of Partnerships

- Consumer Lending
 - LendingClub/Prosper & WebBank
 - Upstart/Affirm & CrossRiver Bank
 - Avant & Regions Bank
- Commercial Lending
 - OnDeck & Celtic Bank/Chase



Examples of Partnerships

- Auto Finance
 - AutoFi & Chase
- Investing
 - Scalable Capital & ING Group
- Payments
 - Stripe & Silicon Valley Bank



How is FinTech Changing Financial Services?

- Simplification and streamlining
- Consumer friendly products and services
- All online delivery
- Regulator interest in supporting innovation
- Different (better?) pricing



Regulatory Interest in Supporting Innovation

- OCC FinTech Charter
- CFPB/BCFP/Bureau
 - No Action Letter
 - Regulatory Sandbox
- Arizona regulatory sandbox
- Treasury's FinTech Report (July 2018)



OCC FinTech Charter

- Preemption without deposits
- Heightened structural requirements
 - Capital, profitability, compliant model
- Regulatory constraints
- CSBS challenge
- Impact on FinTech competition



Bureau's No Action Letter

- Upstart Network, Inc. is the recipient of the only issued No Action Letter
 - Automated underwriting for consumer credit
 - Use of unorthodox factors
 - Access to credit



Arizona Sandbox

- First enacted regulatory sandbox
- Allows experimentation with new products via increased disclosure and supervision, but with waiver of regulatory requirements (such as licensing)



Treasury's FinTech Report

- Supports an overhaul of laws and regulations to support innovation
- Encourages digitization
- Supports bank partnerships with FinTech



How do Bank's Partner?

- Lead sourcing
- Technology provider
 - Benefits of sophisticated technology tailored to financial services without need to develop
- Loan origination
 - Close partnership to originate loans



How do Bank's Partner?

- Payment systems
 - Zelle has partnered with a number of banks and credit unions for streamlined payments delivery
 - Immediacy of delivery and confirmation
 - Simplicity of process



Risks of FinTech

- FDIC's examination guidance on third party lending relationships clarify that the FDIC will treat FinTech partnership similar to a bank's partnership with any vendor
 - <https://www.fdic.gov/news/news/financial/2016/fil16050a.pdf>



Risks of FinTech

- Reputational Risk
- Operational Risk
- Transactional Risk
- Credit Risk
- Compliance Risk



Unique Risks to FinTech?

- Compliance risk – knowledge of federal and state requirements
- Model risk – limited experiential data can challenge ability to accurately assess risk
- Cybersecurity risk – data breach and protection of PII



How to Address Risks

- Indemnification does not absolve you of risk
 - FIL-44-2008
- Understand the business model
- Ensure the relationship is consistent with your strategy



Due Diligence

- Policies and procedures
- Credit quality of loans solicited or underwritten by the third party
- System of internal controls and extent of internal and external audit
- Knowledge and experience of management and staff, particularly firm principals
- Repurchase activity and volume
- Management information systems
- Compliance management systems



Due Diligence

- Results of the institution's monitoring of its third party data
- Consumer complaints received
- Information security program to protect consumer information
- Litigation or enforcement actions
- Earnings strength and adequacy of capital
- Stability of funding sources and back-up sources of liquidity
 - Source: FDIC Examination Guidance for Third-Party Lending (proposed – July 29, 2016)



Monitoring

- Performance monitoring should address:
 - Effectiveness of relationship
 - Licensing and registration requirements
 - FinTech financial condition
 - Audit report review
 - Compliance



Questions?

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