FINTECH — BANK MODEL PARTNERSHIPS

A baseline review of best practices and pitfalls....
Comments by Comptroller Otting before the House Financial Services Committee in June 2018:

“The world has changed dramatically over the last two years.”

“Fintechs used to think that they wanted to be banks; and, now, most are realizing because of the capital, liquidity, and commitment to the community they have to provide, they really don’t want to be.”

“More and more Fintechs are talking to us about how they partner with banks to be able to provide portals and things where they can reach customers.”
SHIFTING TO DIGITAL SOLUTIONS

- Digital/Mobile Banking
- Marketplace Lending
- Payments
- Deposit Gathering
- Banking as a Platform
- Artificial Intelligence/Machine Learning
- “RegTech”
THE SHIFT IN BANKING TECHNOLOGY

“Mobile first, digital everything.”

- Jamie Dimon, J.P. Morgan Chase & Co. on the bank’s new mantra guiding its future growth.

“Our biggest competitors are not necessarily other banks. They are Amazon and Google. Those are the companies setting the expectations of our customers.”

JPMorgan Chase & Co.
The Big 6 banks (Bank of America, Chase, Citibank, PNC, U.S. Bank and Wells Fargo) currently have a jump on regional and midsize banks to build digital engagement.

Prior to the pandemic, 49% of big bank customers had high levels of digital engagement, compared with 41% of regional bank customers and 36% of midsize bank customers.
DIGITAL TRANSFORMATION SPANS GENERATIONS AND CHANNELS

*Source: ABA (Feb. 2021)

CURRENTLY USE DIGITAL BANKING PERSONALLY

COMMERCIAL CUSTOMERS THAT WANT DIGITAL BANKING

*Source: Fraedom (2019)
BREADTH OF OPPORTUNITY

• What we’ve seen as a result of COVID-19 is the move away from cash and towards contactless payments.

• For most banks, digital account opening has been the most popular type of partnership between fintechs and banks. That being said, these partnerships feel more like vendor relationships and not partnerships.

• Digital account openings are only a sliver of the products available through fintech partnerships.
BANK—FINTECH OPPORTUNITIES

Accounts payable processing
Accounts receivable processing
Card (prepaid) sponsoring
Consumer and commercial bill payment
Cryptocurrencies

Financial management and budgeting
International settlement and payments
Investment advisors and broker-dealers
Invoicing and collections
Lending models (consumer and small business)

Merchant acquirer services
Mobile payments processing
Mobile wallet solutions
Online account solutions
SMB payment processing
THE IMPORTANCE OF FINTECH PARTNERSHIPS

**FIGURE 13: Importance of Fintech Partnerships**

How important are fintech partnerships or investments to your organization?

**Banks**
- 2019: 21%
- 2020: 23%
- 2021: 24%

**Credit Unions**
- 2019: 20%
- 2020: 30%
- 2021: 22%

**Source:** Cornerstone Advisors survey of 260 community-based financial institution executives, Q4 2020.
IMPACT OF FINTECH PARTNERSHIPS

**FIGURE 15: Impact of Banks' Fintech Partnerships**

To what extent have your fintech partnerships impacted the following metrics?

- **Loan productivity**: 15% Significant impact (>5%), 34% Moderate impact (<5%), 32% No impact, 19% Negative impact, NA
- **Fraud losses**: 13% Significant impact (>5%), 22% Moderate impact (<5%), 47% No impact, 19% Negative impact, NA
- **Non-interest income**: 11% Significant impact (>5%), 17% Moderate impact (<5%), 49% No impact, 23% Negative impact, NA
- **Loan volume**: 11% Significant impact (>5%), 39% Moderate impact (<5%), 35% No impact, 15% Negative impact, NA
- **Deposit account opening productivity**: 9% Significant impact (>5%), 37% Moderate impact (<5%), 28% No impact, 26% Negative impact, NA
- **Operational expenses**: 8% Significant impact (>5%), 25% Moderate impact (<5%), 35% No impact, 22% Negative impact, NA
- **Overall customer retention**: 6% Significant impact (>5%), 34% Moderate impact (<5%), 39% No impact, 2% Negative impact, 20% NA
- **Deposit account volume**: 6% Significant impact (>5%), 42% Moderate impact (<5%), 29% No impact, 23% Negative impact, NA
- **Up-sell/cross-sell effectiveness**: 3% Significant impact (>5%), 31% Moderate impact (<5%), 42% No impact, 2% Negative impact, 23% NA

Source: Cornerstone Advisors survey of 260 community-based financial institution executives, Q4 2020
MUTUAL BENEFITS TO THE BANK AND FINTECH

FINANCIAL INSTITUTIONS
- Brand/Name recognition
- Large customer base
- Wide range of product offerings
- Comprehensive customer data
- Robust infrastructure
- Advanced underwriting capabilities
- Risk management experience
- Access to capital
- Licensed to provide regulated financial services

SHARED
- Scaled and innovative solutions
- Deeper and analytics-driven customer engagement
- Enhanced risk mitigation
- Improved product efficiency
- More accessible products

FINTECHS
- Culture of innovation
- Nimble
- Agility and speed to market
- Disruptive mindset
- Lean set-up and an absence of legacy systems
- Technological expertise
- Customer data analytics
- Specialized solutions
- Customer data analytics
- Modern IT systems

*Source: Center for Financial Inclusion at Accion and the Institute of International Finance, July 2017
## Bank—FinTech Models

<table>
<thead>
<tr>
<th>Model</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bank Referrals</strong></td>
<td>- Bank earns revenue by sending customers to FinTech</td>
</tr>
<tr>
<td></td>
<td>- Can be used where the bank has “gaps” in service offerings</td>
</tr>
<tr>
<td><strong>FinTech Referrals</strong></td>
<td>- Bank purchases customer leads from FinTech</td>
</tr>
<tr>
<td></td>
<td>- Bank purchases account or loan assets originated inside FinTech platform</td>
</tr>
<tr>
<td><strong>FinTech Investment or Acquisition</strong></td>
<td>- Bank invests in FinTech that is mission aligned to bank</td>
</tr>
<tr>
<td></td>
<td>- Bank buys key technology for private use or sale to other Financial Institutions.</td>
</tr>
<tr>
<td><strong>Private Label Solution/SaaS</strong></td>
<td>- Bank purchases the financial technology to deploy to its customers</td>
</tr>
<tr>
<td></td>
<td>- Opens new product offerings for the bank</td>
</tr>
<tr>
<td><strong>Bank to Bank</strong></td>
<td>- Banks partner with each other to fill respective services gaps</td>
</tr>
<tr>
<td></td>
<td>- Also includes relationships between technology and low-tech banks to offer services.</td>
</tr>
<tr>
<td><strong>Partial Outsourcing</strong></td>
<td>- FinTech assumes limited roles in process—underwriting, data collections, etc.</td>
</tr>
<tr>
<td></td>
<td>- Allows the bank to “buy” technology or expertise missing in the institution</td>
</tr>
<tr>
<td><strong>True “Bank Model Partnership”</strong></td>
<td>- Bank serves as the lender/account issuer in FinTech themed ecosystem</td>
</tr>
<tr>
<td></td>
<td>- Full integration in services with FinTech front-end and bank back-end</td>
</tr>
</tbody>
</table>
OCC & THE STATES—FIGHTS OVER LENDING PARTNERSHIPS

October 29, 2020: OCC issues a Final Rule to address when a bank is the “true lender” in a FinTech lending partnership. If the national bank is listed as the lender in the loan agreement or funds the loan, it is the lender in the transaction. (This is the “fix” for the decision in Madden v. Midland Funding).

January 5, 2021: Attorneys General from eight states file a lawsuit challenging the OCC’s rulemaking. The lawsuit challenged the procedure for adopting the rule and challenges whether the OCC could issue such a determination.

May 11, 2021: Senate passes a resolution under the Congressional Review Act to overturn the OCC’s rulemaking.

June 30, 2021: President Biden signs the resolution thereby rescinding the Final Rule tossing the uncertainty of Bank-FinTech lending partnerships back to a state-by-state analysis.
Will the non-bank “white label” the product?
Who will market?
Who will underwrite?
Who will decision and action applicants?
Who will provide the originations platform?
Who will service?
Who will default service?

Relationship Structure:
- Will the bank retain ownership of the loan? (Participation Model)
- Will the bank transfer the loan? (Whole Loan Sale Model)
- Will the bank obtain a funding line from the investor? (Warehouse Model)
- Will the marketing entity be separate from the financial entity? (3-Party Model)
SIMPLE TO THE COMPLEX
WHERE TO LOOK WHEN MOVING TO DIGITAL

**OCC: Office of Innovation**

- The Office of Innovation, established in January 2017, implements a framework supporting responsible innovation that enhances the safety and soundness of the federal banking system, treats customers fairly, and promotes financial inclusion. The Office of Innovation ensures that institutions with federal charters have a regulatory framework that is receptive to responsible innovation and the supervision that supports it.

**FDIC: FDiTech:**

- The FDIC established FDiTech in 2019 to collaborate with community banks on how to deploy technology in delivery channels and back office operations to better serve customers. The FDiTech team, among other activities, has published manuals and guidance to provide additional tools and resources to increase opportunities for bank partnerships with FinTechs. In February 2021, the FDIC appointed its first Chief Innovation Officer to lead the FDiTech team and to promote the adoption of innovative technologies across the financial services sector.

**Federal Reserve: Innovation Policy:**

- The Federal Reserve Board established the Office of Innovation Policy in 2019 to support responsible innovation among regulated institutions and in the financial markets broadly.

**FFIEC: E-Banking Booklet:**

- Provides guidance to examiners and financial institutions on identifying and controlling the risks associated with electronic banking (e-banking) activities. The booklet primarily discusses e-banking risks from the perspective of the services or products provided to customers.
CFPB SANDBOX

CFPB’s stated mission is to promote innovation, competition, and consumer access within financial services through:

- Creating policies and sandboxes through which we reduce potential barriers to innovation
- Engaging with stakeholders interested in promoting consumer-beneficial innovation
- Coordinating with Federal, State and international regulators

There are multiple programs:

- **Compliance Assistance Sandbox**: a Compliance Assistance Sandbox in which companies can obtain a safe harbor for testing innovative products and services for a limited period of time while sharing data with the Bureau.

- **Trial Disclosure Sandbox**: companies can obtain a safe harbor for testing for a limited period of time disclosures that improve upon existing disclosures, while sharing data with the Bureau.

- **Pitch a pilot**: Groups that have an idea for a consumer-beneficial innovation, and want to work with the CFPB to make it happen, can pitch pilots.
FINTECH SANDBOXES

- **Utah**: Regulatory Sandbox Program was established in 2019 under Utah Code Ann. §13-55-101 to encourage innovative financial products or services by providing participants with limited testing in the Utah market without first obtaining state licenses or other required authorizations.

- **Arizona**: Arizona Revised Statutes §§ 41-5601 to 41-5612, a Regulatory Sandbox for certain types of financial products and services is now available in Arizona. The Sandbox enables a participant to obtain limited access to Arizona’s market to test innovative financial products or services without first obtaining full state licensure or other authorization that otherwise may be required.

- **Wyoming**: Wyoming Legislature enacted HB 57, which created a financial technology sandbox for the testing of innovative financial products and services in Wyoming. An “innovative financial product or service” is defined as a product or service that uses: “new or emerging technology, or new uses of existing technology, that provides a product, service, business model or delivery mechanism to the public and has no substantially comparable, widely available analogue in Wyoming, including blockchain technology.”

- **West Virginia**: West Virginia Legislature passed and the governor signed HB 4621, which implements a regulatory sandbox to enable entities that would normally require licensure in WV to test an innovative financial product or service for a limited period of 24 months. At the end of the sandbox period, if the test of the product or service has been deemed successful, the entity would be able to continue operating in WV subject to any licensure requirements at that team.
FINTECH FINDING A PATH TO CHARTERS

OCC Fintech Charter:
- Initially proposed by the OCC in December 2016, the charter would permit vetted non-depository fintech companies to operate under a federal charter overseen by the OCC without the burdens of state-by-state regulation and licensing. As expected, this was met with significant resistance from state regulators.
- New York Department of Financial Services (“DFS”): *Lacewell v. Office of the Comptroller of the Currency* (dismissed but likely will be re-filed).

FinTech Acquisition/Chartering of Banks
- **Square (an alternative FDIC pathway?):** In March 2020, Square, Inc. became the first U.S. fintech company to receive conditional approval from the Federal Deposit Insurance Corporation’s (FDIC) Industrial Loan Company (ILC) charter to pair with Square’s prior state charter from the Utah Department of Financial Institutions.
- **SoFi – Golden Pacific Bancorp Acquisition:** SoFi, which received preliminary approval for a bank charter in October 2020, sped up the approval process by announcing on March 9, 2021, its agreement to acquire Golden Pacific Bancorp.
- **Lending Club – Radius Acquisition:** On January 19, 2021, LendingClub received final approval from the OCC for its acquisition of Radius Bank.
- **Paxos National Trust:** The OCC granted preliminary conditional approval to charter Paxos National Trust, New York on April 23, 2021.
QUESTIONS OR THOUGHTS?

Neil Grayson
(Chair Financial Institutions Corporate and Regulatory Practice)
Neil.Grayson@nelsonmullins.com
646.428.2600 (New York, NY); 864.373.2235 (Greenville, SC)

Brad Rustin, CRCM, ACAMS
(Chair Financial Regulatory Practice)
Brad.Rustin@nelsonmullins.com
202.689.2320 (Washington, DC); 864.373.2320 (Greenville, SC)

Richard Levin
(Chair FinTech and Regulation Practice)
Richard.Levin@nelsonmullins.com
202.689.2845 (Washington, DC); 303.583.9929 (Denver, CO)

Craig Nazzaro
Craig.Nazzaro@nelsonmullins.com
404.322.6969 (Atlanta, GA)

Kevin Tran
Kevin.Tran@nelsonmullins.com
615.664.5322 (Nashville, TN)

Anastasia ("Tasia") Stull
(Director, Compliance Consulting)
Anastasia.Stull@nelsonmullins.com
850.205.3318 (Washington, DC)

Liz Donaldson
Liz.Donaldson@nelsonmullins.com
864.373.2248 (Greenville, SC)

Randy Saunders
(Banking Litigation)
Randy.Saunders@nelsonmullins.com
304.526.3507 (Huntington, WV)

Samer Roshdy
Samer.Roshdy@nelsonmullins.com
404.322.6712 (Atlanta, GA)

Other NMRS Team Members: