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NELSON MULLINS

FinTech University:
Digital Financial Services Strategies

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Digital Financial Services Strategies: Agenda

- Introduction
- What is included in Digital Financial Services?
- How can you deploy Digital Financial Services?
- How Can you oversee Digital Financial Services, what are the proper controls?
- Conclusions

Introduction

- Given the proliferation of FinTechs, and their cross-over into traditional banking activities, it is incumbent upon banks to keep abreast of all of the developing technology to remain competitive.

- For community banks, innovation to remain competitive is particularly important. According to the FDIC, the most important factor contributing to the earnings gap between community and non-community banks is the ability to generate non-interest income from "activities that are typically not part of the traditional community banking business model."

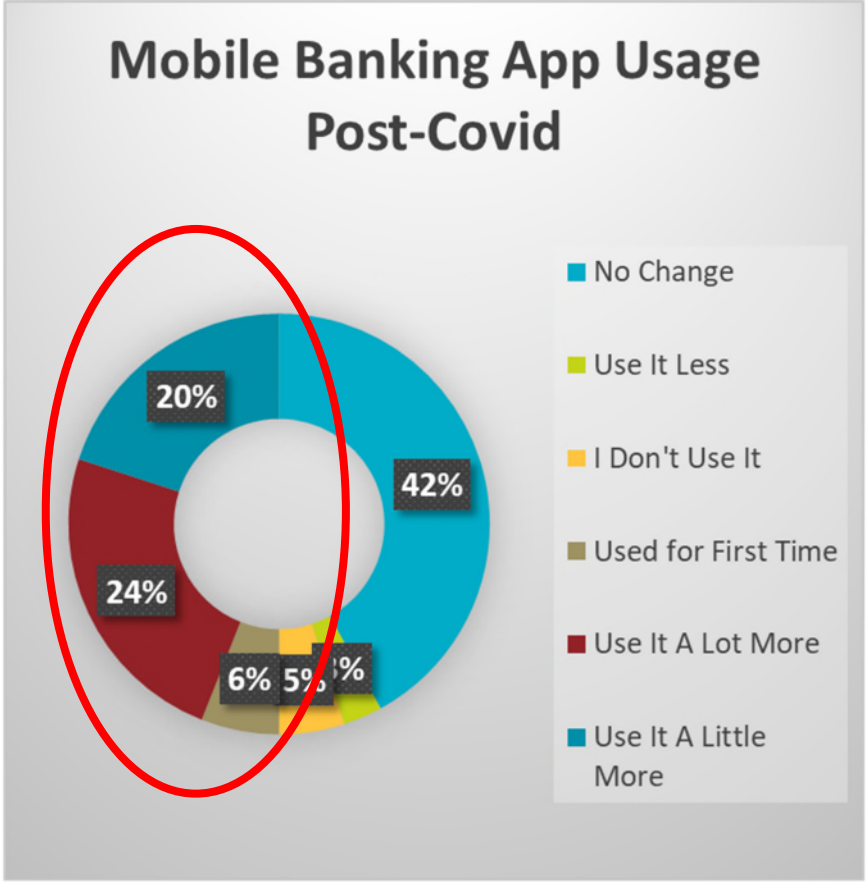
- To that end, banks should consider how FinTechs (and their products and services) can be incorporated into the bank, whether through acquisition, investment or partnerships.

- Relationships with FinTechs can enable a bank to reach market segments which would otherwise be impractical or uneconomic for them to engage in, which can bring exponential growth in deposits, loans, and non-interest income through innovative partnerships while driving customer adoption and customer engagement.

The MIGRATION to Online/Digital Banking

- 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.



The Market Share of FinTech

- According to Ernst & Young research, across all age categories:
- **31% of consumers name a FinTech firm as their primary financial institution, compared to only 6% in 2019.**
- 51% of these consumers have set up direct deposit with a fintech.

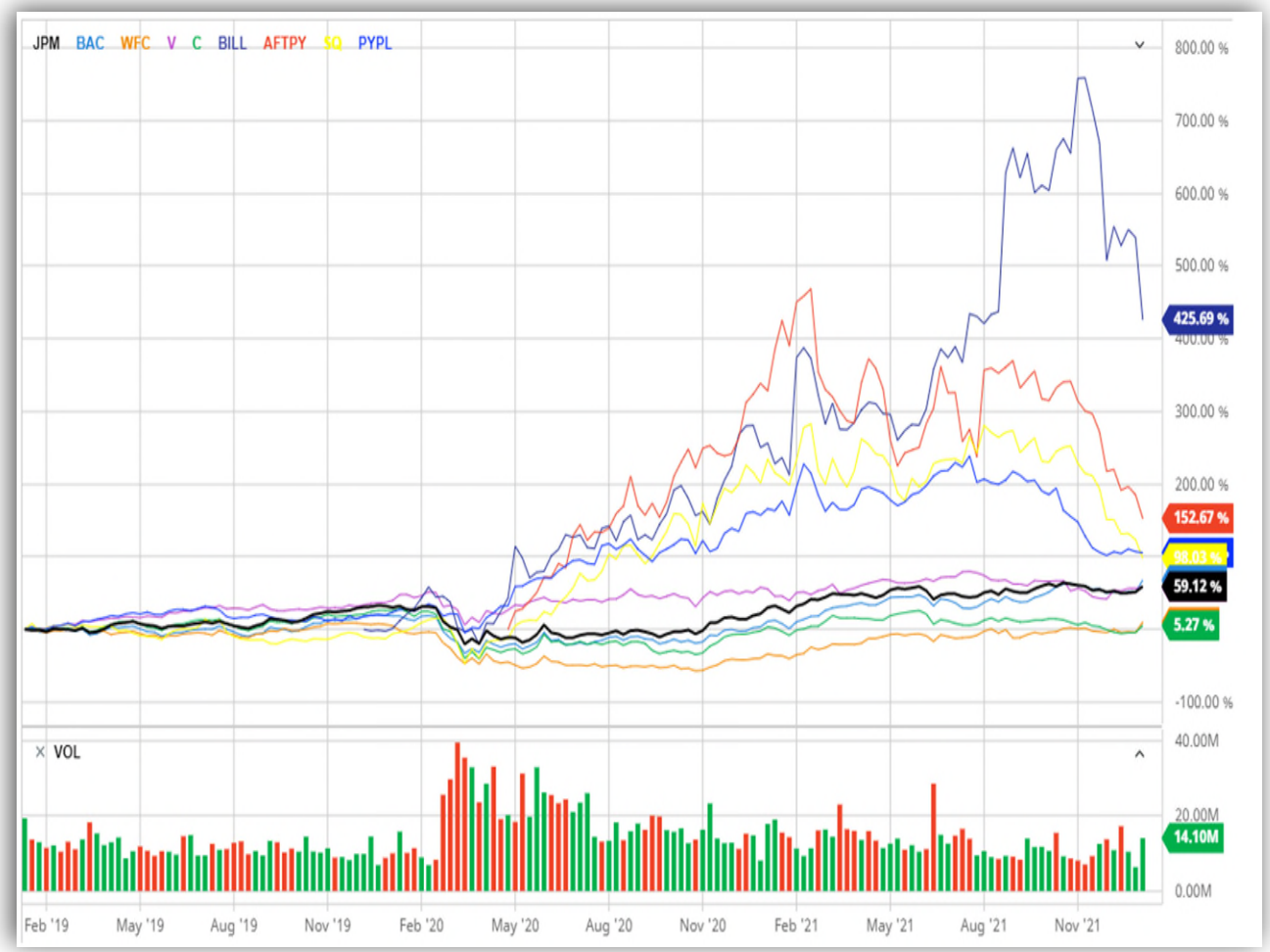
Deloitte's Vision for the Future of Banking

Digital Transformation Imperative in Financial Services - 2030 trends:

- Focus on human-centered future of financial services
- Machine learning eases the delivery of personalized services
- Increased data availability leads to more personalized services
- Consumer demand continues to focus on digital
- Banks keep customers at the core while broadening services offerings
- Banks focus on technology broadening employee capabilities
- Banks focus on operational efficiencies to create a bottom line that fuses people and profit

Source: Deloitte, A higher bottom line: The future of financial services (2021)

Revenue Growth in FinTech



Revenue Growth

- FinTechs have 4x to 6x better revenue growth over the last three years than banks.

Revenues Outside of Financial Services

- 10x the number of FinTechs diversify revenue sources outside of financial services.

Customer Log-Ons Per Month

- FinTechs have 2x the number of customer log-ons and corresponding opportunities for sales.

Number of Cross-Sales of Other Products

- FinTechs have 2x to 3x the number of cross-sales
- Nearly all top-performing FinTechs offer "End-to-End" relationships that include savings, transactional accounts, payments, and unsecured loans.

Cost to Serve

- The cost to serve per customer for a FinTech is less than 40% of a bank, and generally lower than a "Top 10" money-center bank.

Bank - FinTech Models

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

Bank-Model Partnership

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

New Tech – Same Regs

Common problems with strategic FinTech partners arise when the partner may be driven by a tech team and not a banking team, other problems occur when there is no parity in the level of policies and procedures between the Bank and the FinTech. As always, depending on the deal structure, we are looking at:

- Electronic Fund Transfer Act / Regulation E
- Truth in Lending Act / Regulation Z
- PCI – DSS
- BSA/AML/KYC/OFAC/KYC
- UDAAP
- FinCEN – Money Transmission/MSB (Note the deal structure is very important here)
- Gramm-Leach-Bliley Act / Regulation P

Due Diligence: Required for Banks

Banks can partner with payment providers to expand product offerings and functionality, but they must deploy adequate oversight and the required compliance controls.

You must:

- Diligence Prior to Onboarding
- Drafting MSA and SOW
- Ongoing Monitoring
- Demonstrate Subject Matter Expertise

Due Diligence: Required for Banks

Prior to Onboarding

- Determine the regulatory, reputational and litigation risks associated with partner's operation.
- Diligence partner according to level of risk presented. Prepare a diligence overview and retain internally to showcase to regulator that you not only understand the risks but have an informed and justified level of comfort with the partners controls and overall CMS.
- Discuss findings within all appropriate committees, senior managements and share with Board, again always thinking that you will have to defend your position in the event there is a process break within the partners operations.

Due Diligence: Drafting the MSA/SOW

Make sure the MSA and/or SOW provides your Bank with:

- Proper oversight including monitoring and audit rights.
- The proper level of reporting (for example are you seeing complaints?)
- Data privacy controls (are you sharing just enough to obtain the level of services needed)
- Notice from the partner for any and all material changes to scope and or execution.
- Compliance with all laws provision. (***Please Note***: a lot of tech solutions will shift this to Bank, you need to be aware and have a control in place if this is the case)

Bank will need controls in place to avoid project and/or service creep. Look to confirm that your LOB/Ops teams cannot expand or alter the MSA and/or SOW without controls in place to gain legal and or compliance sign off.

Due Diligence: Ongoing

Ensure your Third-Party Oversight (“TPO”) program is robust enough to cover:

- Ongoing monitoring sufficient to manage the level of risk presented by the partner.
- Defines critical vendors (don’t just think of this as critical to ongoing ops/safety and soundness)
- The leveraging of any ongoing reporting that was provided for within the MSA. The data is useless if it is sitting in the Bank untouched.

Bank will need controls in place to avoid project, service creep where the LOB can expand or alter the MSA and/or SOW without controls in place to gain legal and or compliance sign off.

Subject Matter Expertise (”SME”)

- Who is the SME within the Bank – You can outsource almost anything - but you can not outsource the responsibility/liability.
- Your regulator will look to see if you can handle and understand the increased risks brought with the partnership that was deployed.

Due Diligence: Always Required

According to the FTC's complaint against California-based Qualpay, the company for years processed payments for MOBE, a scheme the FTC alleged charged consumers hundreds of millions of dollars for worthless business coaching products, and that Qualpay ignored numerous signs that MOBE was a fraudulent business.

- The red flags listed in the complaint include questions about whether MOBE was a domestic or international company, the nature of MOBE's business model, MOBE's history of excessive chargebacks, and claims MOBE made in its marketing materials about helping consumers make "hundreds of thousands of dollars per year."

- The complaint also alleges that Qualpay failed to follow its own internal policies when it came to managing MOBE's accounts.

- Specifically, the company failed to review MOBE's business practices in detail, which would have revealed numerous elements that should have eliminated MOBE as a client under Qualpay's policies.

OCC Rulemaking on Digital Technology and Innovation

REGULATORY UPDATES: Whether the OCC's legal standards in 12 CFR Parts 7, Subpart E and 155 (National Bank Electronic Activities) are flexible and clear. Whether the standards should be revised to reflect developments in the industry and, if so, how?

ELIMINATE HURDLES: Whether the OCC's legal standards create unnecessary hurdles or burdens to the use of technological advances or innovation.

UNADDRESSED DIGITAL BANKING ACTIVITIES: Are there digital banking activities or issues related to digital banking activities the OCC does not currently address in their legal standards but that should be included?

CRYPTO: What types of cryptocurrency or cryptoassets activities are financial services companies or bank customers engaged in, and what obstacles in the banking industry do institutions face with adoption of these activities?

DISTRIBUTED LEDGER: How is distributed ledger technology (e.g., identity verification, credit underwriting and processing, payment processing, trade finance and records management) used or potentially used in banking activities, and is there any further clarification needed in guidance or regulations?

USE OF AI: How is artificial intelligence (AI) and machine learning used or potentially used in banking activities? Are there ways that AI could be used more broadly but is hindered because of regulatory complexity, lack of transparency, audit complexities, or other regulatory barriers?

PAYMENT TECH: What new payment technologies and processes are available and what are the potential implications for use in the banking industry? How are these technologies and processes facilitated or hindered by the existing regulatory framework?

REGTECH: What new or innovative tools are financial services companies using to comply with applicable regulations and supervisory expectations (e.g., regtech), and how does the OCC's regulatory approach enable or hinder these advancements?

SMALL INSTITUTION IMPLICATIONS: Are there issues unique to smaller institutions regarding the use and implementation of innovative products, services, or processes?

NEW PRODUCTS OR DELIVERY METHODS: Are there other changes to the development and delivery of banking products and services for consumers, businesses, and communities that should be considered?

Encouragement From Regulators: FDiTech

June 2019: Announcement of FDIC's FDiTech initiative to promote the adoption of innovative and transformative technologies in the financial services sector, help FDIC better understand how innovation can contribute to the expansion of banking services, and promote the adoption of technology that can help community banks compete in the modern financial marketplace.

February 2020: FDiTech releases a guide to help FinTechs partnering with banks. The focus is on effective but not burdensome third party risk management strategies.

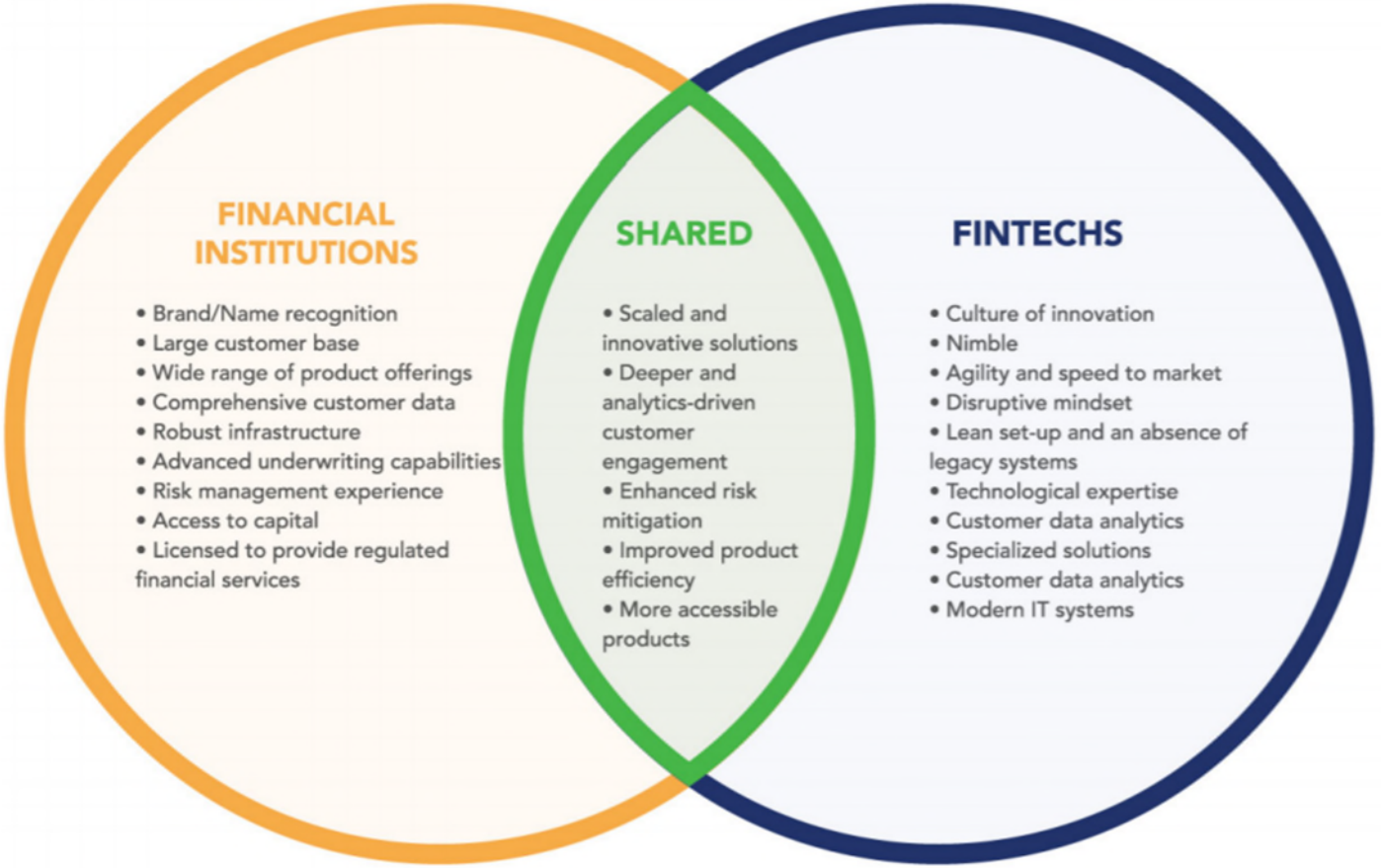
July 2020: FDiTech announces that the FDIC is seeking public comment on a potential public/private standard-setting partnership and voluntary certification program to promote third-party technology adoption across the financial services sector. Importantly, it would help **standardize due diligence practices across FDIC banks**.

July 2021: FDiTech launched Breaking Down Barriers: Reaching the Last Mile of the Unbanked

August 2021: The FDIC, FRB, OCC issued "Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks (Guide)"; which is intended to help community banks in conducting due diligence when considering relationships with financial technology (fintech) companies.

September 2021: FRB publishes "Community Bank Access to Innovation through Partnerships"

Mutual Benefits to the Bank and FinTech



Source: Center for Financial Inclusion at Accion and the Institute of International Finance, July 2017

The Impact of FinTech Partnerships on Bank Value

DIRECT BENEFITS TO THE BANK

Data driven digital insights:
- Full customer picture
- Analytics and data
- Targeted products and services

Integrated Customer Experience
- Customer-centric
- Omnichannel delivery

Digital Marketing
- Targeted marketing
- Content insights
- Customer life-cycle management

Digital Operations
- Customer relationship management
- Streamlined fullfillment

Innovation
- More than 2/3 of FinTechs are in the payments and lending space

THE FOCUS OF INVESTMENT

Payments
- 25% increase in funding for 2021
- (-5%) decrease in deal activity

Banking
- 43% increase in funding for 2021
- 59% increase in deal activity

Digital Lending
- 76% increase in funding for 2021
- 19% increase in deal activity

Wealth Management
- (-21%) decrease in funding for 2021
- ~1% growth in deal activity

SMB Focused FinTechs
- 37% increase in funding for 2021
- 47% increase in deal activity

Presenter Biographies

ANASTASIA STULL

Anastasia ("Tasia") is a senior financial services executive and attorney who brings over 20 years of experience to the Financial Services Regulatory Team. Tasia counsels banks, non-bank lenders, FinTechs, and financial services companies in matters involving consumer, commercial, retail, and institutional financial services. Her hands-on perspective and knowledge of industry trends enables her to provide strategic and practical advice to financial services companies on the challenges they face today.

Tasia is also the Executive Director of Assureg, the firm's regulatory and compliance division that offers innovative, scalable compliance solutions to the financial services industry. For Assureg, she directs strategy, corporate development activities, marketing and business development, oversees client engagements, in addition to being a champion for client relationship management.

CRAIG NAZZARO

Craig advises a variety of entities on all regulatory and compliance issues that impact the financial services industry including banks, non-bank lenders, servicers, investors, third party payment processors, and debt collectors. He also defends clients against charges of liability and regulatory violations.

Craig's prior experience includes serving as a vice president and assistant general counsel with J.P. Morgan Chase, where he managed and coordinated a team of over 20 senior legal officers and attorneys in responding to and resolving consumer lending issues presented by state attorneys generals, Housing and Urban Development, Consumer Financial Protection Bureau, Office of the Comptroller of the Currency, state banking departments, and Congressional inquiries. He also served as the Chief Compliance Officer for Chemical Bank, a $23 billion bank headquartered in Michigan from 2018 until 2019 when Chemical Bank merged with TCF National Bank.

Presenter Biographies

DOWSE "BRAD" RUSTIN, IV

Brad chairs the firm's Financial Services Regulatory Practice. He began his career as a litigator focusing on consumer financial services litigation and defense of regulatory claims against chartered and non-chartered financial institutions, finance entities, and money services business. Following in the wake of the fiscal crisis, he began working with financial institutions, state-licensed lenders, money transmitters, non-traditional lenders, check cashers, and mortgage brokers on issues of regulatory compliance. Brad is a Certified Anti-Money Laundering Specialist (CAMS) by ACAMS and a Certified Regulatory Compliance Manager (CRCM) by the American Bankers Association.

Brad serves as an expert witness of matters relating to financial regulations and compliance. In addition, he serves as an adjunct law school professor, teaching classes on Banking, FinTech, and Financial Services Policy. Brad works with a number of industry organizations focusing on financial institutions and regularly speaks on topics involving regulatory compliance. His speaking engagements have included presentations for the Federal Reserve, the Consumer Financial Protection Bureau, the American Bankers Association, state banking associations, state bankers' schools, and numerous financial industry conferences.

Moderator Biography

RICHARD B. LEVIN

Richard is chair of the FinTech and Regulation Practice and was one of the first lawyers to focus on the regulation of blockchain and digital assets. He is considered a thought leader in the FinTech space. Richard brings his experience as a senior legal and compliance officer on Wall Street and in London to bear in advising clients on corporate, FinTech, securities, and regulatory issues. A problem-solver by nature, he has been advising FinTech clients on legal and regulatory issues since the start of electronic trading in the late 1990s. His practice focuses on helping financial services and technology clients identify and address regulatory issues as they build their businesses.

Richard's practice focuses on the representation of early stage and publicly traded companies in the FinTech space, including investment banks, broker-dealers, investment advisers, peer-to-peer lending platforms, digital currency trading platforms, alternative trading systems (ATSs), exchanges, and custodians. He represents these firms before the U.S. Securities and Exchange Commission (SEC), the U.S. Commodity Futures Trading Commission (CFTC), the Financial Industry Regulatory Authority (FINRA), the U.S. Department of the Treasury, Office of the Comptroller of the Currency (OCC), state regulators, and Congress. Richard has represented clients before regulators in Australia, Canada, France, Germany, Hong Kong, Ireland, Japan, Singapore, South Korea, and the United Kingdom. His current and past clients include leading national financial institutions, multinational financial services holding companies, leading firms in the FinTech space, and institutions engaging in global investment banking, investment management, securities, and other financial services with institutional clients.

Richard has been identified by Chambers and Partners as one of the leading lawyers in the Blockchain and Cryptocurrencies category since the inception of the category. He has been recognized by Chambers for his knowledge on regulatory matters, great relationships with regulators, for helping clients push the boundaries of the FinTech sector, and for his advice on matters such as broker-dealer licensing and alternative trading systems. Richard is routinely quoted by leading publications including Bloomberg, the New York Times, Reuters, and the Wall Street Journal and is a frequent speaker at conferences around the world on the regulation of FinTech, blockchain, and digital assets.

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