



**The evolving Fintech regulatory environment**  
Preparing for the inevitable

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Financial technology (Fintech) firms have won over many investors and consumers with innovative product and service offerings that are often less costly, more convenient, or less complex than many traditional bank offerings. However, as they grow larger in popularity, Fintech firms face more and more scrutiny from federal and state regulators.

In recent years, Fintech companies looking to offer bank-like products or services across state lines have been obligated to apply for multiple state licenses, a time-consuming and complex process. This could change with a recent announcement by the Office of Comptroller of the Currency (OCC). On December 2, 2016, the agency issued a white paper—the third in its Fintech series following white papers in March and October 2016—announcing that it is proposing to create a special purpose national bank charter available to Fintech companies that provide non-deposit banking products and services.<sup>1</sup> The paper requests public comments on 13 questions specific to the proposal, which are due by January 15, 2017.

Consistent with the OCC's whitepaper and an industry forum it hosted in June 2016,<sup>2</sup> the Securities and Exchange Commission (SEC) and the Federal Reserve Board (FRB) have also conducted workshops and forums focused on maintaining a secure financial system while encouraging innovation. In addition, as discussed below, the Consumer Financial Protection Bureau (CFPB) has taken enforcement actions against Fintech marketplace lenders and payment firms, and recently began accepting complaints on consumer loans from marketplace lenders.<sup>3</sup>

Notwithstanding the OCC's proposal to create a special purpose national bank charter available to Fintech companies, state regulators continue to license and supervise these companies, as well as enforce compliance with state laws, regulations, and supervision programs.

Following the OCC announcement, Maria Vullo, Superintendent of the New York State Department of Financial Services (DFS), announced her opposition to "any effort to federalize what states have been doing—and doing well—for over a century."<sup>4</sup>

Further, she stressed that any reliance on a federal Fintech regulatory framework "would be irresponsible if it were to ignore the states' historical role and longstanding expertise in this arena," adding that state regulators are "best positioned to continue to protect consumers" and ensure that Fintech companies are able to thrive within an approximately tailored regulatory framework. These concerns were echoed by the Conference of State Bank Supervisors, which criticized the OCC's proposal as "fatally flawed."<sup>6</sup> As the comment period on the OCC's proposal draws to a close, the agency will be required to respond to such feedback, and explain its views on the issues raised.

### **Federal regulations are not new, but direct federal supervision would be**

Fintech firms are today not directly supervised, examined, or regulated by a federal banking regulatory agency. However, Fintech companies, including marketplace lenders and payment companies, are subject to certain federal regulations.

### **Consumer protection**

The CFPB, Federal Trade Commission (FTC), and the Department of Justice (DOJ) enforce certain consumer protection laws and regulations, and all can bring cases against Fintech companies for noncompliance. For example, the CFPB recently issued a consent order involving unfair, deceptive, or abusive acts or practices (UDAAP) against a company that operates an online payment platform, alleging that it misrepresented its data security practices to consumers.

In addition to the enforcement example, the CFPB has expressed

concern with consumer data and privacy, and expects that consumers are informed of: how their data is being transferred through payment systems, what data are being transferred and who has access to this information, and how these data may be used and the potential risks to the consumer. Meeting these criteria requires that Fintech companies safeguard consumer information with robust data security measures and controls that are thoroughly tested on a regular basis to ensure they are working as prescribed.

### **Bank Secrecy Act/Anti-Money Laundering (BSA/AML)**

Similarly, certain Fintech companies, such as those that qualify as a money service business (MSB), are subject to the same BSA/AML laws and regulations as other financial institutions, with enforcement by the Financial Crimes Enforcement Network (FinCEN) and the US Treasury Department's Office of Foreign Assets Control (OFAC), as appropriate. There are consequences of significant fines or other enforcement action provisions for noncompliance.

### **Indirect supervision through bank and vendor relationships**

However, all Fintech firms may be subject to BSA/AML and other safety and soundness requirements as a result of their relationships with banks. Regulators are asking banks to "know your customer" (KYC) and, in turn, bank management is asking the same question of Fintech firms, which banks underwrite, take deposits from, and transact with as customers. Banks look to them to have an established BSA/AML program. In addition, under the Bank Service Company Act, the FRB, FDIC, and OCC may indirectly examine Fintech companies that provide services to, or partner with, banking organizations through vendor relationships. For these companies, which are already subject to examinations, issues like cybersecurity, information security, guidance on third-party relationships, and AML have become top supervisory concerns.

## Possible future state of federal regulation

Independent from the OCC's proposal to establish special purpose national bank charter, the CFPB has moved toward federal supervision of certain Fintech companies. For example, the Bureau expressed its interest in innovative payment technologies and systems offered by Fintech firms through its July 2015 publication of guiding principles for faster payment networks.<sup>6</sup> In addition to collecting consumer complaints from marketplace lenders, the CFPB is also planning to propose a rulemaking to supervise and regulate "larger participants" in markets for consumer installment loans and vehicle title loans.<sup>7</sup> The Bureau also launched an initiative in 2012 (Project Catalyst) to promote consumer-friendly marketplace innovation.

### OCC proposal

The OCC's proposal extends beyond consumer protection and focuses on prudential supervision, setting forth its baseline safety and soundness and compliance expectations for a Fintech company seeking a national bank

charter. Specifically, the white paper outlines these expectations across seven categories: (1) a robust, well-developed business plan, (2) governance structure, (3) capital, (4) liquidity, (5) compliance risk management, (6) financial inclusion, and (7) recovery and exit strategies; resolution plan and authority.

Further, as noted in the OCC white paper, if a Fintech company has or plans to have a holding company that would be the sole or controlling owner of the bank, the Bank Holding Company Act (BHCA) could apply, which would trigger additional regulatory requirements. Also, a Fintech company that proposes to accept FDIC-insured deposits would be required to receive separate approval from the FDIC.

### Designing the risk-intelligent organization

Regardless of whether a Fintech organization prospectively opts to apply for a federal charter, or multiple state licenses, the organization will be subject to similar risk and control expectations. In this regard, regulatory expectations will include:

- A *comprehensive strategic and business plan* addressing market viability and compliance and risk management framework with capital and liquidity stress testing applied and discussion of alternative business scenarios.
- The need to undergo a *formal and multi-step charter application and approval process* with the OCC or similar scrutiny from State financial regulators.
- An *agile compliance and risk management framework and infrastructure* that can be adapted to comply with existing and new laws and regulations, whether state or federal, and to provide the kind of controls required to ensure safe and sound operations.

Based on our experience working with bank and non-bank financial organizations, we have identified eight components that should be part of a sound risk management framework. Each component requires effective design, methods for continuous improvement, and ongoing assessment across people, process, and technology.

## Fintech risk management framework

Component	Description
Regulatory interaction and coordination	Develop an enterprise-wide view of regulatory activities, planned examinations, and interactions with regulators.
Governance and operating model	Define roles and responsibilities across all functions and businesses, including decision rights and activity/process handoffs.
Risk assessment and regulatory change	Map activities and control to defined laws, regulations, and industry standards; determine residual risk that will drive the frequency of monitoring and testing. Test controls for design effectiveness and appropriateness. Establish a change management process to accommodate new or amended regulation, and product offerings.
Policies, procedures, and related controls	Develop strategies, policies, procedures, and controls that reflect the organization's risk appetite. Align risk management and business strategies with consistent goals and objectives that are measurable.
Monitoring and testing	Define scope and frequency for monitoring and testing based on risk assessment results and remediation plans.
Data, measurement, and reporting	Identify key risk and performance indicators (KRIs / KPIs), and monitor progress with regular and consistent capture, measurement, and reporting of risks.
Communications, awareness, and training	Develop communications and training based on defined training needs. Identify areas where there have been risk issues and develop applicable training and track resolution of those issues post training.
Escalation, resolution, and validation	Ensure transparency of issue escalation and associated remediation plans to sustainability by identifying risk-related processes, tools, and escalation channels.

### Federal or state direct supervision? Which is best?

As with most complex questions, the answer is “it depends.” Each Fintech organization has unique goals, products, opportunities, and challenges. The OCC is now in the process of identifying the standards for obtaining and maintaining a charter. States may also collaborate to rationalize the licensing processes to encourage Fintech oversight at the state level. While there are many unknowns, the regulatory standards are expected to be rigorous, and companies should increasingly expect to be held to the same standards as applied to the banking industry.

### Next Steps

As noted above, comments on the OCC’s December 2016 white paper are due on January 15, 2017. As firms and

industry trade organizations prepare to submit feedback to the agency, they should pay careful attention to related developments.

For example, on December 20, 2016, the OCC issued a final rule addressing the conduct of receiverships for national banks that are not FDIC-insured and for which the FDIC would not be appointed as receiver.<sup>8</sup> Some commenters on the proposed rule argued that the OCC should refrain from chartering special purpose national banks engaged in Fintech activities, while others suggested that the OCC should consider receivership and the associated cost for these companies. The OCC said it will “consider the broader comments on Fintech chartering submitted as part of this rulemaking together with those” that it receives in response to its

December 2016 white paper.<sup>10</sup> In addition, in response to comments on cost considerations, the OCC noted that it “continues to consider what approach to assessments would be appropriate should it approve charters for special purpose national banks engaged in Fintech activities.”<sup>11</sup> Any modification to the assessment structure would be proposed for public comment separately.

At Deloitte Advisory, we are closely monitoring regulatory opportunities and challenges for Fintech companies. Our experience has shown that uncertainty can provide opportunities for prepared organizations to put distance between themselves and their competitors. We welcome the opportunity to talk with you about how your organization may most effectively prepare for this changing regulatory environment.

### Endnotes

<sup>1</sup>Office of the Comptroller of the Currency, “Exploring Special Purpose National Bank Charters for Fintech Companies,” (December 2, 2016), available at <https://www.occ.treas.gov/topics/bank-operations/innovation/special-purpose-national-bank-charters-for-fintech.pdf>.

<sup>2</sup>Office of the Comptroller of the Currency, “Forum on Supporting Responsible Innovation in the Federal Banking System,” (June 23, 2016), available at <https://www.occ.treas.gov/news-issuances/news-releases/2016/nr-occ-2016-55a.pdf>.

<sup>3</sup>Consumer Financial Protection Bureau, “CFPB Now Accepting Complaints on Consumer Loans from Online Marketplace Lenders,” (March 7, 2016), available at <http://www.consumerfinance.gov/about-us/newsroom/cfpb-now-accepting-complaints-on-consumer-loans-from-online-marketplace-lender/>.

<sup>4</sup>New York State Department of Financial Services, “Statement by DFS Superintendent Maria T. Vullo Regarding the OCC Special Purpose National Bank Charters for Fintech Companies,” (December 2, 2016), available at <http://dfs.ny.gov/about/press/pr1612021.htm>.

<sup>5</sup>Conference of State Bank Supervisors, “Statement by the Conference of State Bank Supervisors on Comptroller’s Announcement of New Federal Charters,” (December 2, 2016), available at <https://www.csbs.org/news/press-releases/pr2016/Pages/120216.aspx>.

<sup>6</sup>Consumer Financial Protection Bureau, “CFPB Outlines Guiding Principles for Faster Payment Networks,” (July 9, 2015), available at <http://www.consumerfinance.gov/about-us/newsroom/cfpb-outlines-guiding-principles-for-faster-payment-networks/>.

<sup>7</sup>Current Regulatory Plan and the Unified Agenda of Regulatory and Deregulatory Actions, Consumer Financial Protection Bureau, “Supervision of Larger Participants in Installment Loan and Vehicle Title Loan Markets,” available at <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201610&RIN=3170-AA07>.

<sup>8</sup>Office of the Comptroller of the Currency, “Receiverships for Uninsured National Banks,” (December 20, 2016), 81 Fed. Reg. 92594, available at <https://www.gpo.gov/fdsys/pkg/FR-2016-12-20/pdf/2016-30666.pdf>.

<sup>9</sup>Id. at 92596.

<sup>10</sup>Id.

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