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Client Alert: FDIC Publishes *Conducting Business with Banks: A Guide for FinTechs & Third Parties*

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Related Practice Areas

Financial Institutions

FinTech

February 25, 2020 - *Barack Ferrazzano Client Alert*

Highlights Issues to Consider When Working with a FinTech

Action Items

If your bank wishes to partner with a FinTech, consider the following

- Are you **up to date on all of the recent regulatory developments** related to FinTech activities?
- Have you performed **adequate due diligence** on the FinTech?
- Have you had **potential agreements with FinTechs critically reviewed** in light of the new guidelines?
- We are **available to discuss** any questions you may have as you consider FinTech partnerships.

Conducting Business with Banks: A Guide for FinTechs & Third Parties

On February 24, 2020, the FDIC published a new guide as part of its FDiTech series titled *Conducting Business with Banks: A Guide for FinTechs and Third Parties*. A link to the guide can be found here: https://www.fdic.gov/fditech/guide.pdf

The guide discusses third party risk management with a focus on new technologies and partnering with FinTech entities. The principles in the guide are applicable to whether the bank is using a FinTech as a vendor or if a bank is providing a service to a FinTech, such as Banking-as-a-Service

("BaaS").

The principles in the guide are consistent with prior Barack Ferrazzano *Client Alerts*:

- Offering Banking-as-a-Service?
  - https://www.bfkn.com/newsroom-publications-363
- New FDIC Guidance on Technology Service Provider (TSP) Contracts
  - https://www.bfkn.com/newsroom-publications-341
- FinTech Regulatory Update - Bank & FinTech Agreements
  - https://www.bfkn.com/newsroom-publications-340
- Working with a FinTech? – 5 Things to Know
  - https://www.bfkn.com/newsroom-publications-328
- Client Alert Update: FinTech & Bank Partnerships
  - https://www.bfkn.com/newsroom-publications-ca_201705_fintechbank

The FDIC's advice is also consistent with prior OCC remarks discussing financial technologies and banks offering new products, a link to which can be found here: https://www.occ.treas.gov/news-issuances/news-releases/2017/nr-occ-2017-125.html

Although the FDIC is attempting to provide guidance to banks working with FinTechs, they are doing so within the existing framework of risk management and vendor management principles. Specifically, the main takeaway from these new guidelines is the **FDIC expects banks to apply careful due diligence and critical contract review when considering FinTech contracts**. Even if your bank is not regulated by the FDIC, the principles embodied in the guidelines provide an outline of the critical issues to consider when working with a FinTech.

We Can Help You

Barack Ferrazzano Financial Institutions Group attorneys are currently working on a wide range of partnerships, contracts, and related agreements between banks and FinTechs. Please contact us if you are interested in discussing any potential FinTech partnership or vendor opportunities.

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Client Alert: Offering Banking-as-a-Service?

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January 9, 2020 - *Barack Ferrazzano Client Alert*
10 Legal Considerations When Offering BaaS

Action Items

- **Review our In-Depth: 10 Legal Considerations When Offering Banking-as-a-Service ("BaaS").**
- **Board & Senior Management Education.** Educate your Board and Senior Management about BaaS issues.
- **Infrastructure & Operations.** Evaluate your infrastructure, operations, Compliance Management System ("CMS"), and existing third-party agreements.
- **FinTech Due Diligence.** Perform comprehensive due diligence on potential FinTech BaaS clients.
- **Continuous Evaluation.** Continually evaluate your BaaS operations, regularly review and revise your program management agreement, and other third-party agreements. Prepare for your FinTech-related examination and promptly address any issues.

What is "BaaS?"

BaaS allows banks to offer FinTechs and their customers access to regulated bank products — such as federally insured deposit accounts — and is transforming banking by allowing banks to serve and profit from this market. However, BaaS involves operational, reputational, and regulatory risk if not properly conducted.

Client Alert: Offering Banking-as-a-Service?

Rapidly evolving financial technology and regulatory attitudes are increasing the demand for banks to provide BaaS to FinTechs. BaaS is generally an end-to-end process that allows FinTechs to connect with banks' systems, so they can build banking offerings on top of the banks' regulated infrastructure, and access federal deposit insurance. BaaS is an extension of open banking, in which a bank opens its application programming interface ("API") to a third party for data or functionality access. BaaS can also increase a bank's deposit base and non-interest income if done correctly.

Recently, FDIC Chair Jelena McWilliams commented about bank and FinTech partnerships at the Money 20/20 Conference:

The last few years have shown that banks and FinTechs can not only coexist but coexist in a symbiotic union. There is an opportunity for FinTechs to provide something that the banks are unable to do in as agile and technologically advanced [an] environment. There's an opportunity for banks to expand their offerings and customer base and services through the FinTech.[1]

[1] See https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/55258773

Top 10 Considerations

Here is an overview of our "10 Legal Considerations When Offering Banking-as-a-Service." Click here to review each step in more detail: https://www.bfkn.com/10-legal-considerations-when-offering-baas:

1. **Board & Senior Management Education/Involvement**
2. **Bank Infrastructure**
3. **Policies & Procedures**
4. **Third-Party Relationships**
5. **FinTech Due Diligence**
6. **The Program Management Agreement**
7. **BSA/AML Expectations**
8. **Operational**
9. **FinTech Examinations**
10. **Exit Strategy**

We Can Help You

Over the last few years, we have helped develop BaaS programs for our clients. Whether providing training to Boards and employees, assisting with policies, procedures and program management agreements, interacting with regulators and the bank's vendors, addressing practical concerns and advising about FinTech, we can help your bank successfully develop, manage and grow BaaS.

Please contact us if you are considering offering BaaS, or if you want to discuss how to develop and leverage your existing BaaS relationships.

Client Alert: New FDIC Guidance on Technology Service Provider (TSP) Contracts

April 24, 2019

Proactive Risk Management is Key

Action Items

- **Review your bank's policies to ensure that relationships with Technology Service Providers ("TSP") are sufficiently vetted by management and overseen by the board.**
- **Assess your bank's existing TSP contracts to ensure compliance with current TSP and third-party vendor management guidelines.**
- **For all potential TSP contracts and renewals of existing contracts, negotiate robust protections for the bank, especially in connection with business continuity and data security.**

FDIC FIL-19-2019 – Technology Service Provider Contracts

The FDIC recently issued FIL-19-2019 regarding Technology Service Provider Contracts, which can be found at: https://www.fdic.gov/news/news/financial/2019/fil19019.html. The letter addresses deficiencies FDIC examiners found in many TSP contracts that, among other things, insufficiently addressed business continuity risks and data breach/cyber security incidents. We have observed the FDIC (and other bank regulators) raise these issues in recent exams. The topic is especially timely and critical in light of the growth of FinTech relationships, which often contain a TSP element.

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The principles enunciated by the FDIC in FIL-19-2019 involve both the contractual issues examiners identified and the necessity of proactive risk management. Even if the FDIC is not your bank's primary federal regulator, these principles are indicative of the evolving expectations in this area.

Contractual Inadequacies

The FDIC's guidance focused on contractual inadequacies, including:

- **Absence of a requirement** for the vendor to maintain a business continuity plan (with established recovery standards and defined remedies if standards are not met);
- **Lack of defined procedures** if a service disruption or security incident occurs; and
- **Vague and unclear terms** outlining the bank's rights and the service provider's responsibilities in the event of a service disruption or security incident.

Proactive Risk Management

A bank's directors and senior management retain primary responsibility for overseeing and managing the risks that accompany technology outsourcing relationships. Accordingly, whether a TSP relationship is new or has been in place for some time, Banks are encouraged to take the following measures:

- **Ensure** that TSP contracts adequately address business continuity and incident response risks;
- **Assess** gaps in existing agreements, including those arising from the absence of clearly defined terms or specific requirements concerning business continuity and incident response provisions, to avoid confusion in the future; and
- **Implement** compensating controls to mitigate any risks resulting from gaps in contractual continuity and incident response provisions.

TSP contracts are frequently offered to banks with little time to properly vet them from due diligence, regulatory, and legal standpoints. Don't let that happen. Your bank needs to follow best practices in managing TSP relationships to ensure contractual protections and adequate risk oversight and compliance.

We Can Help You

Please contact us to review your bank's current and potential TSP contracts and if you are considering a new TSP relationship, renewing an existing TSP contract, or if you want to discuss how to address an existing TSP relationship in light of the FDIC's guidance.

We have addressed trends in this area in recent *Client Alerts* regarding TSPs, third-party vendor management, and FinTech relationships:

- Client Alert: FinTech Regulatory Update – Bank & FinTech Agreements
  - » https://www.bfkn.com/fig_201903ca_fintech_regulatoryupdate
- Client Alert: Working with a FinTech? – 5 Things to Know
  - » https://www.bfkn.com/fig_201812ca_fintech
- Client Alert: Updated Regulatory Risk Management Guidance
  - » http://www.bfkn.com/fig_201711_occ_update
- FinTech Opportunities for Your Bank: A Voyage Into New, But Not Uncharted Waters
  - » https://www.bfkn.com/newsroom-publications-247
- Client Alert Update: FinTech & Bank Partnerships
  - » https://www.bfkn.com/newsroom-publications-ca_201705_fintechbank

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Client Alert: FinTech Regulatory Update - Bank & FinTech Agreements

April 3, 2019 - *Barack Ferrazzano Client Alert*
A Discussion of Emerging Critical Issues

Action Items

Before entering into any FinTech agreements, your bank should consider the following:

- **The relationship with the FinTech**
- **Your own bank's FinTech goals and strategy**
- **FinTech related laws and regulations**
- **Contact us to review and help develop any new, modified, or expanded bank products or services to ensure they are compliant**

Recently, Barack Ferrazzano **Financial Institutions Group** partner **Stanley F. Orszula** participated in a roundtable in Washington, D.C. with banks, FinTechs, regulators, and FinTech thought leaders and scholars that focused on FinTech regulatory and compliance issues, especially with bank agreements. The critical emerging issues discussed that could potentially affect banks were:

- Unsupervised machine learning and artificial intelligence credit scoring models ("AI Credit Models"); and
- Third party vendor risk management.

The latter topic has previously been addressed by the Financial Institutions Group here:

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Related Practice Areas

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Client Alert: FinTech Regulatory Update - Bank & FinTech Agreements

» Barack Ferrazzano FinTech News, Events, & Publications

AI Credit Models

Many FinTechs use proprietary AI Credit Models instead of FICO scores in their lending models. **Unsupervised (by humans) AI Credit Models can result in the FinTech platform discriminating against legal sensitive characteristics, which could potentially violate the Equal Credit Opportunity Act ("ECOA") and Regulation B ("Reg B").** The problem is FinTechs keep their underlying AI Credit Models highly confidential and will not share this information with their bank partners. Accordingly, a bank could inadvertently violate the ECOA and Reg B through a FinTech platform that has an opaque AI Credit Model. Consistent with our prior discussions on this topic, banks need to review this issue critically.

Third Party Vendor Risk Management

Third party vendor risk management is also a critical emerging issue we previously highlighted. Vendor management is an especially critical area in FinTech because most banks will choose to work with a FinTech entity that owns, develops, and services the technology. The disconnect is **many of these FinTech entities have little bank regulatory experience and may be learning as they develop and deploy their products without the legacy regulatory experience.** They may also propose contract terms that expose banks to unnecessary risks. Banks can protect themselves by performing critical review in all stages of vendor management process, but especially with experienced legal counsel reviewing the underlying agreement.

We Can Help You

Please contact us if you are considering a new FinTech product or relationship or if you want to discuss how to approach contract negotiation with a FinTech in light of these issues.

References

- Client Alert: Working with a FinTech? – 5 Things to Know
  - » https://www.bfkn.com/newsroom-publications-328
- Client Alert: Updated Regulatory Risk Management Guidance
  - » https://www.bfkn.com/newsroom-publications-305
- FinTech Opportunities for Your Bank: A Voyage Into New, But Not Uncharted Waters
  - » https://www.bfkn.com/newsroom-publications-247
- Client Alert Update: FinTech & Bank Partnerships
  - » https://www.bfkn.com/newsroom-publications-ca_201705_fintechbank

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Client Alert: Working with a FinTech? – 5 Things to Know

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Related Practice Areas

Financial Institutions

FinTech

December 4, 2018 - *Barack Ferrazzano Client Alert*
Novelty and the Various Risks

Action Items

Before entering into any FinTech agreements, your bank should consider the following:

- **The FinTech entity you are working with**
- **The agreement with the FinTech**
- **The law and regulations related to the arrangement**
- **Your own bank and your FinTech goals and strategy**
- **The relationship with the FinTech**

Financial Technology

We are increasingly helping our bank clients with the negotiation of FinTech (financial technology) agreements. These agreements include, among other things, data analytic services, new products such as enhanced customer experiences and program management agreements where banks act as insured depository support for various payment systems. Recently, some commentators have opined that community banks should not enter into FinTech relationships. Clearly, there are risks involved in these relationships that must be understood and anticipated by the bank, but banks should at least consider this avenue as boards determine how best to address their product and technology concerns and opportunities in the future.

5 Essential Things To Know

Regardless of the product or service, many banks are examining FinTech offerings as a way to enhance their customer's experience or provide additional non-interest income. Because of their novelty and the various risks inherent with working with a FinTech, any potential FinTech relationship should be approached carefully. We have developed a short list of five of the essential things your bank should know if you are considering an agreement with a FinTech:

- **Know the FinTech entity you are working with**
  Your bank should know the FinTech entity you are working with because their reputation could become your reputation.
- **Know the agreement with the FinTech**
  Your bank must understand how the agreement will work in practice, what are the parties' expectations, and if any other parties are involved. You also need to be able to clearly explain the agreement to your board and your examiner.
- **Know the law and regulations related to the arrangement**
  Your bank should understand the various laws and regulations governing the arrangement, especially if it is a novel product or service.
- **Know your own bank and your FinTech goals and strategy**
  Your bank should know whether the relationship fits with your bank's strategy and ability to perform under the agreement.
- **Know the relationship with the FinTech**
  Your bank should know how the relationship will work after it commences and be actively involved in monitoring it. Have the ability to openly communicate with the FinTech entity.

New FinTech products, services and arrangements are being developed every day. Some are going to serve your bank better than others. If your bank considers these five issues when approaching a FinTech relationship, it will help your bank make the right decisions for the best possible result.

We Can Help You

Please contact us if you are considering a new FinTech product or relationship or if you want to discuss how to approach contract negotiations with a FinTech in light of these issues. We have helped banks negotiate agreements with both early-stage FinTechs and industry-leading FinTechs, among others.

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Client Alert Update: FinTech & Bank Partnerships

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Related Practice Areas

Cybersecurity & Technology

Financial Institutions

FinTech

May 2, 2017 - *Barack Ferrazzano Client Alert*

Action Items

If your bank is considering partnering with a FinTech, evaluate the following:

- **Will it fit your bank's strategic plan?**
- **How well do you know your FinTech partner?**
- **Do you understand the deal?**
- **Will the deal pass regulatory and legal muster?**

Recently, the FinTech business model shifted from disrupting banks to collaborating with them, whether in payment services, e-lending, customer experience, data analytics, insured depository support, or in other areas. Consequently, our Financial Institutions Group attorneys are working on a wide range of partnerships and related agreements between banks and FinTechs. Additionally, our clients and our attorneys are receiving more and more inquiries from FinTechs wanting to partner with banks. From our experiences, and as reiterated at the recent FinXTech annual summit in New York City that our attorneys attended, there are four main considerations for partnering with a FinTech. While partnering with a FinTech can be accretive to a bank and fit squarely into the bank's strategic vision, banks should consider the following when evaluating any potential FinTech partnership or agreement:

- **Will it fit your bank's strategic plan?**
  While FinTech partnerships can be very positive for your bank, the first question is to determine whether the partnership fits your bank's strategic vision and innovation plan.

- **How well do you know your FinTech partner?**
  FinTech entities range from early-stage start-ups to more established organizations. Banks need to perform due diligence on their potential FinTech partners to determine if they are an appropriate partner for your bank.
- **Do you actually understand all aspects of the arrangement?**
  FinTech agreements are technical by their nature. Bank senior management and their boards should thoroughly understand the scope of services and pricing before entering into a partnership.
- **Will the deal pass regulatory and legal muster?**
  FinTechs, by their nature, are technology companies, sometimes bereft of comprehensive bank legal and regulatory experience. Thus the legal and regulatory implications of any partnership should be comprehensively analyzed and vetted.

We Can Help You

Currently, our Financial Institutions Group attorneys are working on a wide range of partnerships and related agreements between banks and FinTechs. Please contact us if you are interested in discussing any potential FinTech partnership opportunities.