ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA®

May 31, 2016

The Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Re: Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective

Dear Comptroller Curry:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to provide comment on the Office of the Comptroller of the Currency (OCC) discussion paper, *Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective* (paper). We share the OCC's view that the technology related to lending and other traditional banking services is evolving rapidly as a new generation of consumers enters the vast array of financial services markets around the country. We also agree that different types of community banks have been at the forefront of innovation in managing delivery systems and processes while maintaining strong balance sheets and meaningful levels of high-quality regulatory capital.

We commend the OCC for its attempts to achieve a culture that is receptive to responsible innovation. For example, the OCC has established a dedicated Payment Systems Policy Group that provides examination support, training, and guidance to examiners and acts as a resource to OCC-supervised institutions on innovative and traditional payment structures. Additionally, the OCC has formed an internal working group on marketplace lending to monitor developments in that sector. The OCC is also considering establishing dedicated internal website pages describing resources and training opportunities on innovation for all employees. These actions will not only provide support, training and guidance for examiners but also will provide a valuable

[1] The Independent Community Bankers of America®, the nation's voice for more than 6,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services.

With 52,000 locations nationwide, community banks employ 700,000 Americans, hold $3.6 trillion in assets, $2.9 trillion in deposits, and $2.4 trillion in loans to consumers, small businesses, and the agricultural community. For more information, visit ICBA's website at www.icba.org.

resource to OCC-regulated community banks that are seeking to understand the risks and benefits associated with innovation.

While we support regulatory efforts to encourage innovation by community banks of all shapes and sizes, we have concerns about consideration of a potential limited purpose federal bank charter designed for financial technology companies that wish to access the banking system and avoid state consumer protection laws. Community banks today are subject to an unprecedented level of regulation and supervisory review that regulators continually point to as a signal of great financial strength in the vast financial services industry. Only the creation of financial institutions that are subject to the same rigorous safety and soundness standards as today's community banks should be allowed to operate in this space. Special purpose national bank charters with limited supervision will immediately attain a competitive advantage when measured against traditional well-capitalized and well-managed community banks. The end result is an overburdened traditional community bank system that cannot compete with new bank startups that promote a business model anchored with limited regulation.

Opportunities and Challenges

Community banks face new challenges with regard to the way financial services are offered and consumed as a younger generation desires to shy away from the traditional financial offerings that their parents use to manage their financial situation. Traditionally underwritten lines of credit, mortgage loans, credit cards, and retirement products, with their complex terms and conditions and slow-to-evolve decisioning framework, are being cast aside in favor of quick decision, shorter term, easy access offerings that are designed to appeal to a technologically-savvy consumer. Community banks are ever evolving to meet the needs of their customers in local communities and thus far have been very responsive to the behaviors and preferences being exhibited by younger consumers. For example, community banks of all sizes provide extensive online and remote banking services including remote deposit capture, mobile payments, and real-time account management services across the spectrum of mobile devices.

However, community banks have been slow to adopt the rapid advance small dollar lending services that online marketplace lenders promote and young consumers desire out of fear of undue scrutiny by their prudential bank regulators. Regulators have sent very clear messages that they want community banks to be very careful when they offer small dollar loan products to consumers out of fear that the banks will use such products to prey on their own customers. The opportunities in this space lie not with banks but with the regulators themselves, who need to give community banks the flexibility to lead the path to common sense small dollar lending both through rapid fire online solutions and in-person relationship-based credit lines. Regulation promulgated by key stakeholders like the OCC and the Consumer Financial Protection Bureau should not become a barrier to allowing community banks to do what they do best—providing tailored lending solutions to consumers and small businesses based on each borrower's ability to manage debt service.

Bank Charters

ICBA notes that regulators are considering the possibility of a limited purpose federal bank charter that would be designed to accommodate certain banking services for online marketplace lenders and other financial technology companies. Such a charter would certainly subject the online lenders to more oversight and regulation than they have now—particularly in the areas of consumer protection and fair lending, and possibly in safety and soundness. To some extent, this would help to level the playing field that currently exists between online marketplace lenders and banks. ICBA has been very concerned about the regulatory advantage that now exists with online marketplace lenders and supports a regulatory framework for online lenders that is no less stringent than the framework that applies to community banks.

However, ICBA is concerned that the banking regulators may approve or promote creation of a limited purpose banking charter that is subject to only limited safety and soundness supervision and examination. For instance, if such a charter did not have authority to take deposits, the charter may be subject only to a compliance supervision and examination. ICBA believes that the recent problems that some of the online marketplace lenders have experienced with liquidity and earnings, as well as with compliance, makes it important that these lenders be subject to safety and soundness supervision and regulation. These companies have not experienced a serious economic downturn yet and already they have been subject to serious funding and capital issues. Furthermore, ICBA has also seen how other limited purpose bank charters have evolved—such as with the industrial loan companies—and is concerned that any limited purpose fintech bank charter could end up having all of the advantages and benefits of a full service bank charter with limited supervision and regulation.

Third Party Service Providers

As community banks strive to meet their marketplaces' rapidly advancing needs, they must find ways to develop new products, services, and processes, while assessing and mitigating existing and emerging risks associated with integrating those new products and services. To do this successfully, and remain competitive in both the consumer and small business markets, community banks must rely on a variety of third parties providing services ranging from core processing, technology services, payment processing and other functions.

The significant interconnectivity and collaboration of third parties with community banks provide economies of scale and back office efficiencies which enable community banks to provide fair access to financial services and integrate responsible innovation into their business goals.

Third parties provide an enormous benefit to community banks by streamlining operations and offering consumer-facing products that are easy to use. For instance,

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mobile banking is a feature that is now common in today's marketplace, but was previously considered a new innovative product. Developing and creating a mobile banking platform in-house would have required tremendous resources and significant and specific technical expertise. Expending such resources for a new and innovative product – despite the demands for such a product by the consumers – unquestionably puts community banks with limited resources at a significant disadvantage without the ability to rely on third parties. As such, community banks would not be able to keep up with the rapid and dramatic advances in financial technology.

The OCC is seeking comment on the challenges community banks face with regard to emerging technology and financial innovation. As stated previously, community banks are reliant on the relationships and collaboration with third parties to even consider safe and responsible innovative advancements in financial technologies. Community banks conduct due diligence, in accordance with regulatory requirements, to assess and manage the risks associated with third party relationships. Included in their obligations are the requirements to:

- Conduct a review of a potential third party to understand and control the risks posed by the relationship before signing a contract;
- Negotiate the contract so that it, in part, limits the bank's liability, and mitigates disputes about performance; and,
- Perform ongoing monitoring of the third-party relationship which can include monitoring the quality and sustainability of the third party's controls, service-level agreements, performance metrics and compliance with legal and regulatory requirements.

As community banks conduct their due diligence, they often face challenges because they generally will not have the size and scale that larger institutions have for negotiating power. For example, the implementation of adding the "dot bank" Internet domain has been particularly troublesome for some community banks that have reserved their domain names. "Dot bank" is a new domain that provides additional security and comfort for both the financial institutions and consumers who use it because of the added security measures. However, ICBA has learned that some third party providers will not support the new domain name because of the costs of changes required to the third party's system. This is especially problematic for community banks that do not have the leverage to negotiate such a request. Community banks are faced with either not taking advantage of the technological advances that are available or investing in the extremely timely, costly and burdensome task of changing their third party relationship.

The OCC is seeking feedback on ways to enhance its process for monitoring and assessing innovation as well as ways to revise existing guidance to promote responsible innovation. ICBA encourages the OCC to work with its sister agencies to expand the Multi-Regional Data Processing Servicer Program (MDPS), which implements the supervisory program for the largest, systemically- important technology service

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providers,[2] to also include financial technology firms, regardless of their size or industry risk concentration. The current program allows for a coordination of agency efforts in the evaluation of the firm as well as a "single Report of Examination" which is provided to the firm and to the firm's clients.

However, it is mostly the larger third parties with concentrated risk that are generally the focus of regulatory examinations. Examinations of these companies provide some assurances to their customers, and to themselves, that they meet a certain level of safety and soundness –assurances that are not enjoyed by small technology companies and their customers. Expanding examination to include more third parties would encourage higher security standards across the industry and provide consistency to the small third party providers as well as their bank customers. It also provides another layer of scrutiny, in addition to the bank's diligence, on the practices of the third party.

Additionally, limiting examinations to only the largest processors gives those third parties a competitive edge over small businesses when banks are initially requesting proposals and conducting a review of potential relationships. With the benefit of a successful regulatory examination, these companies are more apt to obtain more clients, continue to grow their market share and reduce competitive market forces. Furthermore, such a trend places community banks at a disadvantage when negotiating contract terms and requesting certain audits and documentation consistent with their regulatory responsibilities.

The OCC is planning to evaluate existing guidance on third-party risk management and assess whether additional guidance is appropriate to address the needs of banks and their customers in the rapidly changing environment. ICBA recommends that the OCC streamline the existing obligations of the initial due diligence requirement. Banks are responsible for compiling and submitting initial requests for proposals (RFP) from third parties. Banks must evaluate a third party's financial condition, business experience and reputation, legal and regulatory compliance program, risk management program, information security program, reliance on subcontractors and insurance coverage.[3]

The process, as it stands today, is inefficient for both banks and third parties. The overlapping and somewhat bespoke agency approach to initial due diligence requirements can be cumbersome for both the bank and third party to manage. Banks are asking third parties a fairly common set of questions that have been asked and answered numerous times by third parties in response to multiple RFPs. For instance, third parties are likely providing the same information when asked for its financial condition, insurance coverage, and business experience. Certainly, there is information being requested by the

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[2] Defined in the IT Booklet, "Supervision of Technology Service Providers," as "mission-critical applications (an application or system is mission critical if it is vital to the successful continuance of a core business activity. An application also may be mission-critical if it interfaces with a designated mission-critical system. Products of software vendors also may be mission critical) for a large number of financial institutions that are regulated by more than one Agency, thereby posing a high degree of systemic risk; or from a number of data centers located in different geographic regions." http://ithandbook.ffiec.gov/it-booklets/supervision-of-technology-service-providers-(tsp)/supervisory-programs/mdps-program.aspx

[3] http://ithandbook.ffiec.gov/ITBooklets/FFIEC_ITBooklet_SupervisionofTechnologyServiceProviders(TSP).pdf

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institution that is specific to the institution, but standard information that is being sought is duplicative and costly.

Streamlining the initial due diligence process creates a known baseline for all institutions that wish to do business with the third party. It also provides community banks with additional leverage in their negotiations with third parties as streamlined information would be provided more readily.

Additionally, publishing general and anonymized information following the examination of a third party or vendor would be particularly helpful for community banks who face a disproportionate burden in vetting vendors. Information may be limited to an analysis of common trends, concerns or findings to assist community banks in vetting potential financial technology firms.

Supporting Responsible Innovation

Community banks support the continued development of a vision that strongly promotes technological advances. This strong vision can be used to allow community banks to reach more customers for more extensive services, particularly those in rural and underserved areas. Additionally, a vision that promotes technological advances will help community banks to reach millennial customers, who have already shown a desire to consume banking services differently from earlier generations. Personal customer service and banking built on traditional relationships will provide a valuable foundation for community banks to effectively embrace technology solutions for the next generation.

To quickly and efficiently embrace new technology, community banks will need to be able to collaborate with those firms that are in the best position to provide banking solutions that both meet the needs of younger consumers and provide the high quality product offerings that community banks are known for. The obvious challenge with collaboration is the introduction of new risks that will need to be aggressively identified and managed by the institution. In order to both manage and minimize these risks, community banks will need to identify and collaborate with partners who are in a strong position to assist in prudent risk management in real time.

Regardless of the excitement around the prospect of innovative banking in communities across the country, the biggest barrier to future innovation for community banks is the regulatory burden these institutions face on a daily basis. Common sense lending decisions are routinely second guessed and superseded by the fear of what a bank examiner might conclude is a violation of regulation or statute. Community bank concerns related to innovative technological advances are no different. Because the prudential bank regulators are not at the forefront of technology advances that become available to community banks, the institutions in many cases must pause for guidance or approval from a regulatory authority.

To resolve these concerns, ICBA would like to see the prudential banking regulators

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place themselves at the forefront of these changes in technology by actively monitoring new developments and opening a forum where community banks can share what they see in their respective markets and seek regulator feedback. Due to the rapid rate at which younger bank customers adopt changes in technology, we believe that active monitoring must be done in real time to ensure that community bankers can stay competitive with non-bank offerings of similar products that may be subject to less regulatory scrutiny.

ICBA recognizes that community banks must adapt to the changing financial services consumption patterns exhibited by younger consumers who are constantly striving for efficiencies in their day-to-day banking activities. Community banks are well adjusted to react positively to these generational shifts and continue unprecedented levels of quality customer relationships for their customers of all ages and backgrounds. With a better understanding by regulators of the costly burden placed on these institutions to provide meaningful banking services, both the bank regulator and the community bank can work together achieve harmonization needed to support responsible innovation in the banking system.

Sincerely,

/s/

Karen M. Thomas
Senior Executive Vice President, Government Relations & Public Policy