



May 31, 2016

Via Electronic Submission

Office of the Comptroller of the Currency
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Re: Response to Questions in “Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective”

Dear Office of the Comptroller of the Currency:

R3 CEV Ltd. (“R3”) appreciates the opportunity to respond to the whitepaper published by the Office of the Comptroller of the Currency (“OCC”) entitled “Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective.”¹ As a nonbank innovator at the center of a consortium of over 50 global banks and financial institutions exploring the application of distributed ledger technology to financial services, R3 is keenly interested in engaging in dialogue regarding innovation and respectfully submits these comments in response to the questions posed in the whitepaper. As Comptroller of the Currency Thomas Curry recognized in his remarks at the Harvard Kennedy School’s seminar the day the whitepaper was released, innovation in financial technology (“fintech”) provides both an opportunity and a challenge for banks – to improve their efficiency, lower costs, and increase security to the benefit of both the banks and their customers. We applaud the OCC for inviting responses to the whitepaper, making efforts to ensure the OCC is receptive to innovation, and fostering an ongoing public conversation around emerging fintech.

As background, R3 is leading an initiative with over 50 of the world’s largest financial institutions to develop ground-breaking commercial applications for the financial services industry that leverage the appropriate elements of distributed and shared ledger technology. Operating in New York, London and San Francisco, the R3 team is made up of financial industry veterans, technologists, and new tech entrepreneurs, bringing together expertise from electronic financial markets, cryptography, and digital currencies.

The questions posed in the whitepaper are about supporting responsible innovation in the Federal Banking System, which the OCC defines to include financial products, services, and processes. Our responses are narrower than the question posed. As an entity focused on developing financial technology, our responses focus on how the guiding principles apply to technology only, not products or services.

¹ Office of the Comptroller of the Currency, March 31, 2016 (“Responsible Innovation Whitepaper”).



1. What challenges do community banks face with regard to emerging technology and financial innovation?

Community banks' role in emerging technology and financial innovation is distinct from that of larger financial institutions, which presents several challenges. First, community banks do not have as many resources to invest in research and development. As a result, they often must accept a lower quality product or one that has been developed by or for global banks or providers to global banks. Second, solutions are more likely to be built for issues facing large financial institutions than those facing community banks. Community banks are forced to make a significant investment in innovation to solve problems that are unique to them, which in many cases is not feasible. As a result, solutions for community bank challenges may not be built quickly, if ever. The third challenge is related to timing. Community banks will not be on-boarded by technology vendors to begin using a new product until after global banks and other major clients are on-boarded.

It is important to view the challenges discussed in the preceding paragraph in context. The business of community banks is very different from the business of global banks and, as a result, community banks are typically not as concerned with innovation across asset classes as global banks are. In fact, in some cases the technology and financial innovation that large banks are willing to invest in will not be of benefit to community banks or the cost-benefit analysis may indicate that the banks would be better served to maintain legacy systems.

R3 is currently exploring how to engage with smaller banks because we believe that their participation in the dialog and the joint exploratory efforts around the adoption of distributed ledger technology would be valuable to them, us, and the market as a whole. R3 is working with individual smaller banks and industry groups to explore ways in which community and other smaller banks may benefit from the work R3 is doing on behalf of the broader industry.

2. How can the OCC facilitate responsible innovation by institutions of all sizes?

In the whitepaper, the OCC recognizes the importance of enhancing the understanding of innovation by the OCC and market participants. That is the necessary first step. The OCC can facilitate responsible innovation by institutions of all sizes by focusing on facilitating responsible innovation generally and trusting the market to build appropriate solutions. Putting in place a regulatory framework around fintech innovation itself will only serve to stifle it. The examples of negative innovation cited in the whitepaper are option adjustable rate mortgages, structured investment vehicles, and complex securities that caused losses for financial institutions and their customers. Those examples are not applicable to the fintech analysis because they are financial products, as opposed to the plumbing underlying the financial system. Additionally, at least during the development stages, regulations currently in place are adequate to manage risk and to encourage responsible innovation in the fintech space.



Distributed ledger technology is in the nascent stages of development and it is of utmost importance that its development not be hindered by premature regulatory intervention. The potential unintended consequences that could result from putting a finger on the scale will negatively impact the technology – both in terms of the time it will take to develop it and the form that it takes, assuming that the technology continues to develop at all.

3. *How can the OCC enhance its process for monitoring and assessing innovation within the federal banking system?*

Based on our interactions with the OCC to date and the publishing of this whitepaper, it is clear that the OCC is heading down a productive path toward understanding fintech and its role in the market, which is key to effectively monitoring and assessing innovation within the federal banking system. The technology and its role in the market are changing and will continue to evolve for years to come. We support the proposal that the OCC provide easily accessible expert resources to its employees to ensure understanding keeps pace with evolution.

We suggest that the OCC and other financial regulators create an innovation task force to interface with market participants and to encourage work cross agency. In order to develop such a public/private task force, we suggest the OCC invite prominent figures in the fintech space as well as prominent regulatees. The task force would provide ongoing monitoring and briefing on innovation and could also foster cross-border cooperation.

The OCC should also pursue opportunities to work first hand with distributed ledger technology and other new fintech. By developing a sophisticated in-house understanding of how various technologies work, and their strengths and limitations, the OCC will be better positioned to regulate those technologies. R3 invites U.S. state and federal regulators as well as their international counterparts to participate in R3's Global Collaborative Lab to see the technology and how it can help with compliance and benefit regulators. Already several global regulators and central banks have agreed to participate, and R3 would welcome the OCC in as well.

4. *How would establishing a centralized office of innovation within the OCC facilitate more open, timely, and ongoing dialogue regarding opportunities for responsible innovation?*

We support the idea of creating a central point of contact on innovation at the OCC and believe that would reduce inconsistencies and inefficiencies. The proposal to create a centralized office of innovation within the OCC is one way to accomplish that goal, though not the only way. The creation of a formal group is not necessary and should not be prioritized over creation of a task force that includes market participants and innovators and interfaces with regulators domestically and abroad.



The task force proposed above combined with the central point of contact discussed in this response would be valuable resources for market participants and other regulators. They would create fora for ongoing dialogue within the OCC and externally.

We also want to suggest that the vetting process may be more appropriately applied to products and services rather than to technologies.

- 5. How could the OCC provide guidance to nonbank innovators regarding its expectations for banks' interactions and partnerships with such companies?*

In order to provide the most effective guidance on such partnerships, we believe that it is of utmost importance to understand what those partnerships are for and what the nonbank innovators are developing for banks. To do so will require meeting with as many innovators as possible, including those you identify from your regulatees and those who approach the OCC to request a meeting. Additionally, fostering ongoing public private partnerships and conferences will ensure information on interactions stays current.

The OCC and nonbank innovators should maintain an open dialogue so that both can evolve together. The OCC should provide nonbank innovators with insight into what regulatory and policy issues need to be taken into account when designing technology solutions. Nonbank innovators should also provide the OCC with periodic updates on technological developments and invite the OCC to provide input as to how the technology can be made community bank friendly.

- 6. What additional tools and resources would help community bankers incorporate innovation into their strategic planning processes?*

We suggest that the OCC organize and sponsor collaborative working relationships, education sessions, and other similarly open and inclusive events to help highlight innovations in financial technology, including the issues those innovations are designed to address, to ensure that community bankers stay abreast of developments and have the opportunity to strategize about incorporation of the new technologies into their respective banks. The OCC should also continue researching and inviting small banks to share ideas with technology providers and nonbanks innovators. It is important to note that innovations in fintech can create efficiencies that benefit the entire market, including banks and market participants of all sizes.

- 7. What additional guidance could support responsible innovation? How could the OCC revise existing guidance to promote responsible innovation?*

At this early stage in development of new fintech, the most prudent approach is “wait and encourage.” The most apt analogy to the emerging technology in the financial markets today, which includes



distributed ledger technology and blockchain technology, is to the Internet. During the nascent stages of development of the Internet, Congress passed the Telecommunications Act of 1996, which represented a bipartisan effort to expand existing regulation to include the Internet, without stifling its development. More stringent regulation during those times could have significantly slowed the growth of the Internet or changed forever its role in communications and commerce. We ask that regulators take a similar approach to technology that is in the early developmental stages now – wait and encourage the technology to develop and only then take bipartisan action to adapt regulations to the innovations. As Comptroller of the Currency Curry recognized in his preface to the whitepaper, innovation holds much promise and the risk management around it should not impede its progress.

8. *What forms of outreach and information sharing venues are the most effective?*

There are a variety of venues that are effective for information sharing and each has particular advantages. It is important to use a mix of these approaches in fostering open conversation. Information sharing among joint task forces fosters regulatory harmonization and efficiencies; conferences and what the OCC termed “innovator fairs”² provide information to the public and can effectively facilitate discussion amongst various market participants; whitepapers often times provide a more in depth and focused discussion and request comment on discrete points. Efforts such as this whitepaper and its accompanying request for comment should be replicated on a periodic basis to ensure information stays fresh and provides the timeliest insight.

9. *What should the OCC consider with respect to innovation?*

First, the OCC should consider the best way to foster a “wait and encourage” regulatory approach to the development of new financial technologies. R3 believes that fintech itself should not be the subject of regulatory oversight. Rather, regulations should continue to target behaviors, entities, and markets over which the OCC has jurisdiction. By focusing on regulated entities and working with them to encourage the use of cutting-edge technology across the industry as a whole, the end customers of the banks will be the ultimate beneficiaries of innovation.

Second, the OCC should consider various ways to actively engage with the private sector – both financial services companies and technology companies alike – to better understand and support the new technologies coming to market. Public policy objectives will best be achieved working in conjunction with the drivers of innovation, ensuring that regulatory concerns are taken into account during the design and construction of new technologies, not as an afterthought.

Third, the OCC should consider the numerous benefits new technologies could provide to market participants as well as regulators. Innovation will help financial services companies improve security,

² *Id.* at 10.



scalability, efficiency, and reliability in their infrastructure. Innovation will also drive costs lower. Regulators will gain enhanced abilities to oversee markets and enforce the rules. By working together as these technologies mature, the entire market will benefit.

We appreciate the opportunity to submit these comments and welcome further discussion.

Respectfully yours,

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Charley Cooper

Managing Director, R3