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**So, you want approval to
become a bank?**

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In our point of view publication from last year, “So, you want to be a bank,” we described the specific strategic considerations and options financial technology companies should consider when deciding whether or not to “join them” rather than “beat them,” and what the actual journey for entry into the banking system may entail. Today, we dive deeper into what it takes to move from a desire to acquire a banking license to meeting the explicit and implicit price of admission for entry and getting the “all clear” from regulators.

Over the last year, there have been several announcements by fintech companies who have filed with regulatory agencies, including the Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller (OCC), and various state agencies (collectively, the “regulators”) to enter the banking system, either through de novo formation or via acquisition, with particular interest in industrial banks and full-service national or state-chartered banks. Numerous other companies have shared draft applications with the regulators for feedback.

At present, no fintech company has formally applied for the OCC’s uninsured special purpose national bank (i.e., the so-called fintech charter), although we understand that some fintech companies without the need for deposit funding of their operations have expressed preliminary interest in it. Overall, as evidenced by innovation offices now at the OCC, FDIC, and Consumer Financial Protection Bureau (CFPB), the regulators have expressed a willingness to work with fintech companies in their bank charter pursuits, notwithstanding the importance of the regulators applying scrutiny to their business plans and applications consistent with policy and practice.

The contents of a charter application and its corollary business plan can be summarized as follows:



Identifies individuals within the organization who are familiar with applicable banking laws and regulations



Describes how the entity will be operated in a safe and sound manner



Describes overall governance structure, including competent senior management and a board of directors (the “board”) with the ability and experience relevant to the type of products and services to be provided



Demonstrates how the business model poses acceptable risk to the Federal Deposit Insurance Corporation’s (FDIC) Deposit Insurance Fund, if applicable



Provides enough capital and liquidity in relation to the proposed business plan



Demonstrates that the business model is consistent with applicable federal and state banking laws and regulations



Demonstrates how the entity can reasonably be expected to achieve and maintain profitability through financial forecasts



What does it take?

In our experience, there are aspects of the application that will receive the greatest scrutiny, and, therefore, become the most pivotal in the ability to move forward with a banking charter.



Sound business plan (including financial projections):

Perhaps one of the most obvious elements in the approval decision is the alignment of an institution's business plan with the regulators' objective of permitting entry to only those organizations that have a reasonably strong prospect for success; have a full understanding of the challenges ahead of them, including downside risks; and have grounded their strategic vision in reasonable assumptions. Many companies are following innovative strategies that can pose particular challenges or risks that need to be described and addressed.



Demonstrating near-term profitability:

Regulators are asking de novo and established companies to demonstrate that their approach will lead to profits and capital augmentation early in the bank's growth years. While early losses are the norm for many startup operations, regulators have a lower risk tolerance for early loss periods for banks, given that their activities are backed by federally insured deposits. They understand that, in the current low-rate, low-spread environment, it may be difficult to overcome startup costs while scaling to profitability. To the extent profitability is forecasted to be relatively weak or assumed to take a longer period to normalize, an application's prospects may be at risk. In those cases, a greater scrutiny will be placed on the parent company's capacity to serve as a source of strength. Again, the reasonableness of assumptions will be important in convincing regulators of prospects for near-term profitability.



Demonstrating market research for business model:

Regulators would like to understand the data and market research that support the potential bank's focus on product, customer, and market. Leveraging existing data can help support the credibility of the business plan. The business model should describe the institution's business and any special market niche, their value proposition against competitors, and any nontraditional activities in which the bank would engage. The expectation is that the business model should be grounded and demonstrated through market research statistics and comprehensive competitor study.



Adequacy of proposed capital:

In order to demonstrate that the proposed initial capital and liquidity levels are sound, regulators are looking at companies to consider risks inherent in the firm's business model; potential variability in earnings projections, skill, and ability of the management team to carry out their business plan; and a parent company that can serve as a source of strength to the newly formed bank. The supporting analysis should include stress testing and sensitivity analysis.



Adequacy of risk management design and infrastructure:

Regulators want to see a robust three lines of defense (business line, independent risk management, and internal audit) at the outset, supported by processes related to cyber risk, third-party risk management, anti-money laundering/sanctions, information technology controls, and compliance management, among others. They also expect to see established asset and credit quality processes commensurate with regulatory and bank expectations. In addition, regulators will expect an end-to-end model risk management program to be in place, especially for companies that rely on innovative models to make their decisions around approving/sourcing customers or underwriting, pricing, originating, or valuing their products.



Understanding of restrictions on intercompany transactions:

It is expected that the business plan should demonstrate an understanding of restrictions on transactions between the bank and its affiliates. The bank is expected to draft appropriate agreements to govern intercompany transactions and perform appropriate monitoring and reporting (e.g., compliance with Federal Reserve Act 23A and 23B).



Qualifications of the proposed board and senior management:

While the business plan may look reasonable to regulators, their own experience has shown them that a sound plan must be backed up by an experienced and qualified board and senior management team commensurate with the size and complexity of the bank. The application must demonstrate that they have the competence, experience, financial resources, integrity, and character to meet financial obligations and lead a supervised financial institution in a safe-and-sound manner. They are also looking for that leadership to be committed to a presence in their community.



Compliance with applicable banking regulations:

Regulators expect applicants to illustrate plans and capabilities to demonstrate compliance with regulatory requirements. This includes a significant focus on the Community Reinvestment Act (CRA).

Hot-button potential issues

In addition to the success factors highlighted above, the following hot-button issues will receive additional scrutiny and may make the application and approval process lengthier and more challenging:

Soundness of monoline product business model

With a single or narrow product line, companies need to specifically identify how they will manage the inherently greater concentration risk (in customers, products, geography, or business activity) through more sophisticated risk management, capital, liquidity, and other means. Focus will also be on competitive market analysis regarding volumes, pricing, and terms and conditions, along with downside risks that speak to the sustainability of a monoline strategy.

Soundness of digital/nontraditional funding model

On the liability side, if most of the growth is forecasted to come from deposits sourced over the Internet through premium rates, regulators will likely view these as wholesale funds. Historically, customers who do not have basic checking, direct deposit, or other relationship(s) with the bank are less loyal. Therefore, to demonstrate the customer base is willing to hold deposits, regulators will expect companies with nontraditional funding strategies to have more formalized and well-defined liquidity contingency plans, as well as higher overall liquidity and more sophisticated liquidity risk measures. The funding model discussion should also be grounded in reasonable assumptions regarding the competitive landscape and customer/counterparty behavior.

New digital banking technologies and models

Whether a fintech company is deploying its own “homegrown” technology or relying upon third-party vendors to provide the technology, especially for core data processing and decision modeling, the regulators will look “under the hood” to gain confidence in the efficacy of the design and effectiveness of controls including around credit soundness, fair lending, and anti-money laundering.

Parent company/ownership structure

Regulators are sensitive to complicated ownership structures, especially foreign ownership, which may take much longer to evaluate and process applications.

Charter choice

The type of charter will impact timing for the evaluation process (e.g., legislative considerations around a fintech charter may make it both difficult for companies to obtain and for regulators to approve).

Legal entity (LE) structure

Regulators are sensitive to LE structures where bank holding companies (BHCs) have activities in nonbanking legal entities that may pose systemic risk or cause resolvability issues. It is also important to demonstrate that the new bank will own resources or have sufficient access to shared resources to ensure bank activities are executed with minimal dependency on nonbank entities. Considerations related to governance for dual-hatting employees for such a legal entity structure are also important.





Preview your application with regulators

Whether an application is submitted to the OCC, FDIC, FRB, and/or state regulators, taking advantage of the “draft application process” offered by the regulators is highly recommended to surface any issues early, thus enabling applicants to address any perceived issues, particularly in the areas highlighted above.

After the application, what is next?

Subsequent to preliminary charter approval, but before the receipt of all final regulatory approvals, is the stage involving the bank operationalization and pre-opening examination and/or BHC inspection processes. This is the point where organizational management needs to operationalize the bank while regulators seek to better understand whether what was illustrated in the business plan application is backed by solid plans, infrastructure, and people. Regulators will be looking to see whether there truly is an understanding of the required level of risk management, governance, and infrastructure to open the doors on day one. Quite often, examiners will leave behind a significant to-do list before final approval is granted. One particular challenge this poses to fintech companies is their ability to bridge the gap between the agile, less formal fintech governance culture and the formality expected by the regulators relative to governance, policies and procedures, analysis, and decision making, and to do so in a way that successfully leverages and preserves the fintech company's culture and operations.

How Deloitte can help

We can help clients translate the implicit and explicit capabilities of becoming a bank while aligning to the overall strategy of the company by bridging the gap between banking application regulatory requirements and a company's existing business model.

We can also help facilitate the process to reach alignment on the preferred bank chartering option to enable you to move forward. Once the preferred chartering option is identified, we can help you with regulatory advisory, development, and project management support across the new charter life cycle, from business plan to application to bank organization, opening, and beyond. In doing so, we bring together our deep regulatory knowledge and experience with our extensive understanding of fintech companies. Starting up a bank while continuing to operate a successful enterprise is no small task, and doing so in a way that honors and maintains your company's culture can help you ensure that the bank has strategic advantages and a viable future.

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