



Fintechs and regulatory compliance

Understanding risks and rewards

October 2017

“We are not financial institutions” historically has been a core fintech mantra heard around the industry. Unconstrained by many regulatory requirements applicable to banks and other financial institutions, fintechs pride themselves on creating deep customer connections, navigating market trends agilely, and creating disruption for traditional competitors.

Many fintechs have effectively achieved these results by delivering disruptive solutions that transform payments, lending, wealth management, and more. However, recent regulatory and industry developments suggest a potential blurring of the lines between fintechs and other financial institutions. The regulatory community is recognizing that fintechs are offering services similar to those from traditional institutions. As a result, some fintechs are abandoning the “not financial institutions” mantra to consider or pursue bank charters, both to compete more broadly and to avoid having to address disparate regulatory requirements at the individual state level where they conduct business. Simultaneously, banks are courting—and, in some cases, are already working with—fintechs to leverage

their disruptive capabilities and address the demands of tech-savvy consumers.

As the future brings new risks related to increasing regulatory expectations, along with potential penalties and legal actions for non-compliance, fintechs can no longer maintain that they are unlike traditional financial institutions in their delivery of products. This paper begins a series of three points of view (POV) that offer a brief look at the risk landscape fintechs face today and how they can thrive in a more regulated business environment. The two follow-up POVs will explore governance and business considerations for fintechs planning to pursue a bank charter, as well as a framework and its associated elements of a fintech regulatory risk and compliance model.

So many ways to err

Diverse in their origins and fact patterns, recent regulatory actions (see Figure 1) specific to fintechs share several traits. First, they do not discriminate by size or reputation; some involve fintechs that are household names, while others target less-known startups. They are all recent and illustrative of the regulatory action

being taken today, the oldest action being initiated in 2015. Notably, they highlight the regulatory, operational, and reputational risks fintechs face – risks that in many respects align with those that oftentimes threaten the safety and soundness of a bank or other financial institution.

A review of some two dozen such actions found that about half involved consumer mistreatment, one out of five related to a privacy violation, and the remainder were Know Your Customer infractions, intellectual property thefts, and other matters. In even more recent news, an FBI investigation into potential terrorist financing being carried out through a leading marketplace fintech company¹ brought to light the risk fintechs face with their customers.

At the same time, the focus on consumer treatment is worth noting. The number of actions focusing on customer treatment suggest that consumers expect regulatory protection associated with fintech products and services that are bank-like, yet are delivered through non-traditional channels that focus on ease and pace of access.

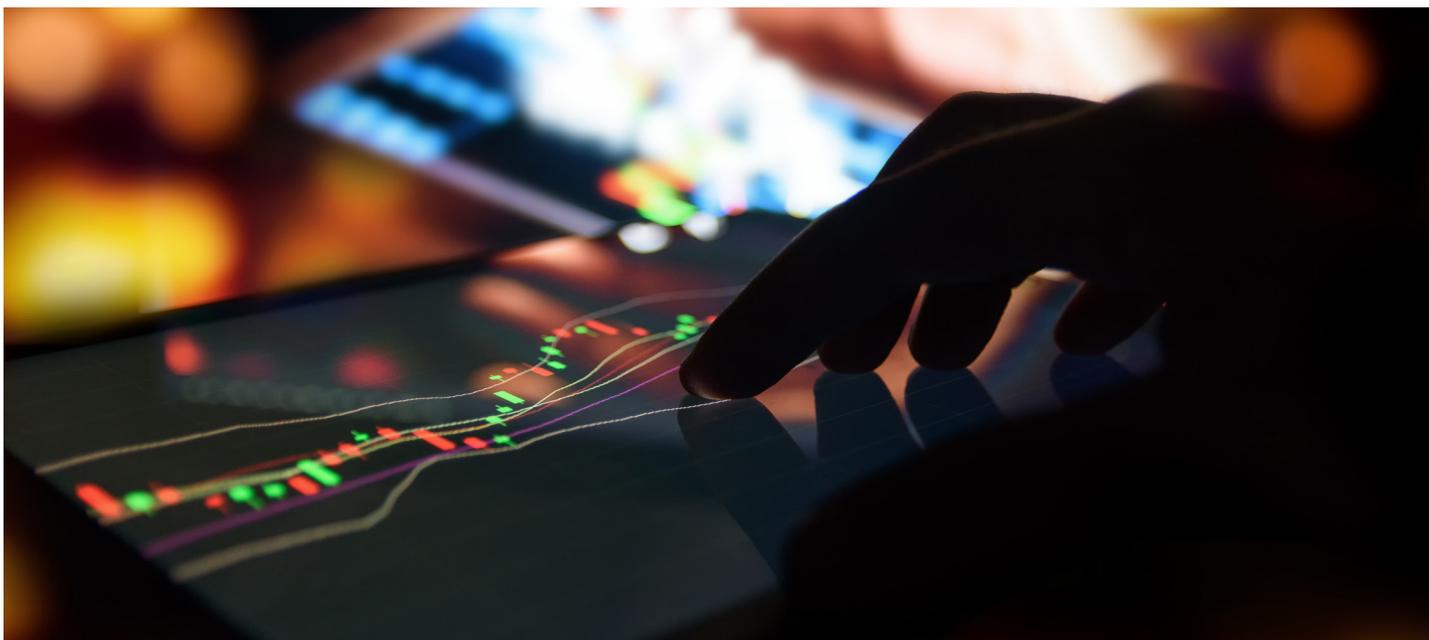
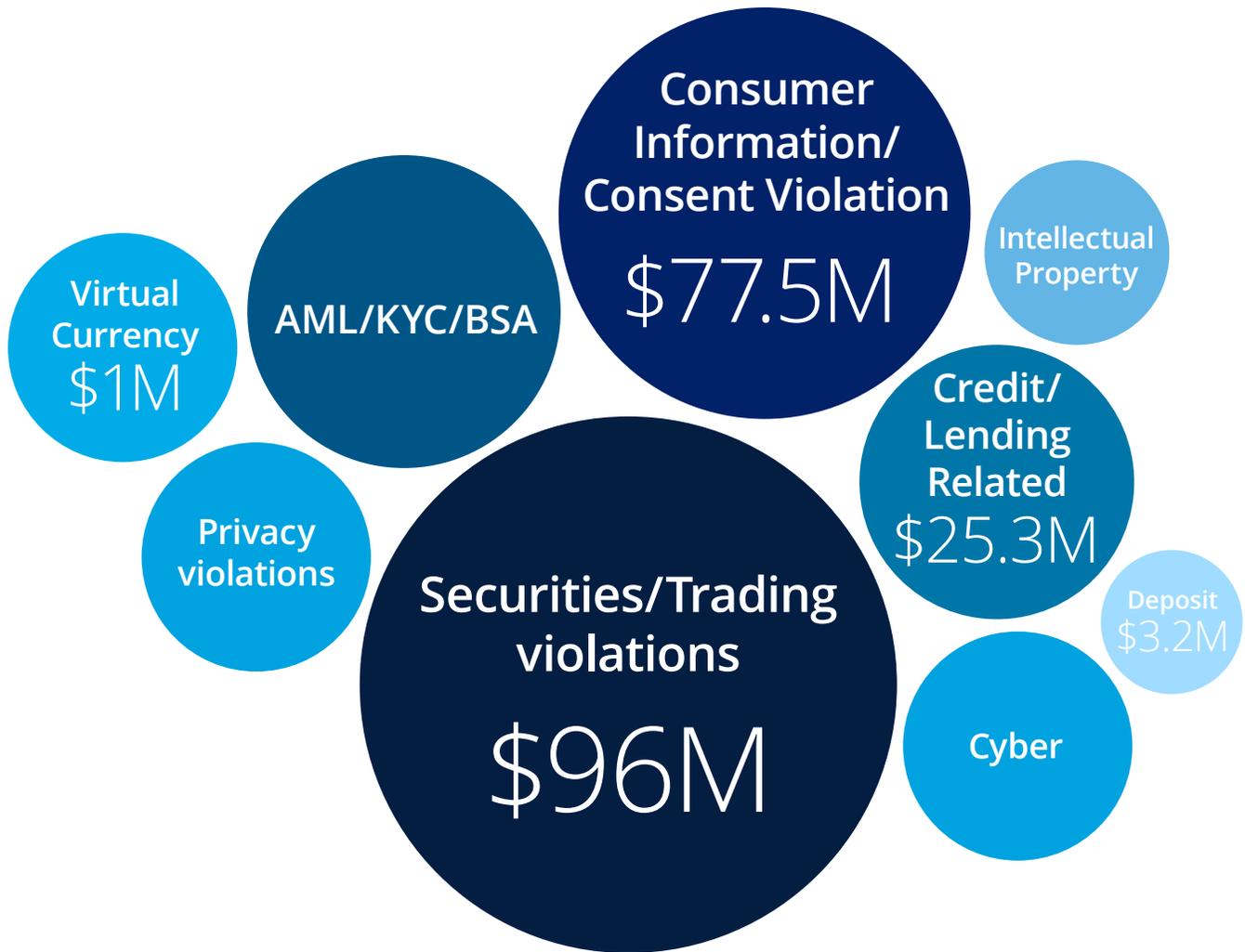


Figure 1. Recent regulatory actions involving fintechs



Disclaimer - Size is relative to number of actions. Fines or lawsuit settlement amounts are included when publicly available.

Rising regulatory voices

Currently, the regulatory agencies have differing approaches to fintechs and banking innovation, but several are making advances towards supervision. In March 2016, the Office of the Comptroller of the Currency (OCC) published a white paper on its “vision for responsible innovation in the federal banking system.”² As a result of this initiative, the door opened for fintechs to continue their pursuit of growth by working collaboratively with regulators to develop solutions specific to the regulation of their product offerings. In October 2016, the OCC announced the creation of

a new Office of Innovation intended to be a “central point of contact and clearinghouse for requests and information related to innovation” and to establish an “outreach and technical assistance program for banks and nonbanks.”³

In December 2016, the OCC advanced this effort when then-Comptroller of the Currency Tom Curry announced that the agency “will move forward with chartering financial technology companies that offer bank products and services and meet [its] high standards and chartering requirements.”⁴ Notably, the decision to apply for a charter—

which the OCC describes as a special purpose national bank charter—would be a choice for fintech companies rather than a new requirement (i.e., they could continue to operate without a federal charter and remain subject to individual state supervision and regulation). On July 19, 2017, speaking before the Exchequer Club in Washington, DC, Acting Comptroller of the Currency Keith Noreika discussed the responsible innovation initiative, marking the first major remarks on the issue under the agency’s new leadership. Although there was previously some uncertainty with respect to whether the OCC would continue the initiative under the

“Hundreds of fintechs presently compete against banks without the rigorous oversight and requirements facing national banks and federal savings associations”

current political environment he expressed strong support for it, characterizing the proposal to grant special purpose national bank charters to fintech companies as “a good idea that deserves the thorough analysis and the careful consideration [OCC is] giving it.”⁵

In addition, he noted that “hundreds of fintechs presently compete against banks without the rigorous oversight and requirements facing national banks and federal savings associations,” concluding that providing charters to fintech companies would “help level the playing field in meaningful ways.” However, he also emphasized that the OCC “has not determined whether it will actually accept or act upon applications” from fintech

companies, but will continue to hold discussions with interested companies as it evaluates several options.

Coincidentally, six days after the Acting Comptroller’s remarks, Varo Money, a mobile-only fintech company, decided not to wait for the OCC to conclude its deliberation regarding the special purpose national bank charter. The company filed an application with the OCC for a full national bank charter and a complementary application with the Federal Deposit Insurance Corporation (FDIC) for deposit insurance.⁶ While dispensing with brick-and-mortar branches, the bank would model a traditional bank in fundamental ways such as taking deposits, cashing checks, and making loans.

Through its application to the FDIC, Varo became the second fintech company to seek FDIC insurance. The FDIC’s decision whether or not to grant new ILC charters could have major implications for the fintech industry. (In early September 2017, press reports indicated that Square, Inc., a payment processing fintech company, will also apply for an ILC charter.⁷)

Separately, other regulatory agencies have voiced their interests and intentions regarding fintechs. For example, the Commodity Futures Trading Commission (CFTC) created LabCFTC as part of its commitment to understand “the changing landscape of the market and what impact that will have on policy and ultimately



the Commission's regulations⁸ specific to fintechs involved with capital market futures products.

While the charter story unfolds, other authorities are also addressing fintech-related regulatory concerns. In June 2017, the Financial Stability Board (FSB), an international organization that makes recommendations regarding the global financial system, published a report on the financial stability implications of fintech firms. Although the report concludes that there are "currently no compelling financial stability risks from emerging fintech innovations," it identifies 10 supervisory and

regulatory issues that "merit authorities' attention."⁹ These risks, which mirror those facing traditional banks and extend beyond obvious threats such as cybersecurity attacks, will require attention to risk management frameworks and resources (a topic we will cover in more detail in the second installment of this POV series).

Adjusting to the new landscape

Regardless of the approach fintech companies take to regulated markets—whether becoming a chartered institution or remaining as they are—they can increase their potential for success by having solid risk management controls in place. Given

increasing regulatory attention and the need to have controls in place to both know and treat customers well, a compliant company may well be more attractive to the public. That differentiation might open doors to market share and revenue growth. It might also give a level of comfort to a variety of stakeholders, including the consumers the company interacts with, the company's board and management, analysts (both rating agencies and equity) who value the transparency of risk management practices of companies, and any regulatory organizations that might take interest in the company.

Next in our FinTech series: Risk and compliance considerations for fintechs

Leadership

Gina Primeaux

Principal
Deloitte Risk and Financial Advisory
Deloitte & Touche LLP
+1 916 718 9597
gprimeaux@deloitte.com

Peter Reynolds

Managing Director
Deloitte Risk and Financial Advisory
Deloitte & Touche LLP
+1 973 602 4111
pereynolds@deloitte.com

Contributors

Harish Dakshina

Senior Manager
Deloitte Risk and Financial Advisory
Deloitte & Touche LLP
+1 973 602 4000
hdakshina@deloitte.com

Amanda Williamson

Senior Manager
Deloitte Risk and Financial Advisory
Deloitte & Touche LLP
+1 704 887 2069
amawilliamson@deloitte.com

J.D. Simpson

Senior Manager
Deloitte Risk and Financial Advisory
Deloitte & Touche LLP
+1 816 881 5197
jasimpson@deloitte.com

Deloitte Center for Regulatory Strategy

Chris Spoth

Executive Director, Center for
Regulatory Strategy
Deloitte & Touche, LLP
+1 202 378 5016
cspotth@deloitte.com

Endnotes

- <https://www.wsj.com/articles/fbi-says-isis-used-ebay-to-send-terror-cash-to-u-s-1502410868>
- Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective, Office of the Comptroller of the Currency, March 2016, <https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf>
- OCC news release, October 26, 2016, <https://occ.gov/news-issuances/news-releases/2016/nr-occ-2016-135.html>
- Remarks by Thomas J. Curry, Comptroller of the Currency, December 2, 2016, <https://www.occ.treas.gov/news-issuances/speeches/2016/pub-speech-2016-152.pdf>
- Keith A. Noreika, Remarks, Exchequer Club, Washington, DC, July 19, 2017, <https://www.occ.gov/news-issuances/speeches/2017/pub-speech-2017-82.pdf>
- "Mobile-only fintech makes play for (regular) bank charter," July 25, 2017, American Banker: <https://www.americanbanker.com/news/mobile-only-fintech-makes-play-for-regular-bank-charter>
- <https://www.americanbanker.com/news/square-to-apply-for-industrial-bank-inflaming-ilc-debate>
- Lab CFTC Overview: <http://www.cftc.gov/LabCFTC/Overview/index.htm>
- "Financial Stability Implications from FinTech: Supervisory and Regulatory Issues that Merit Authorities' Attention, 27 June 2017, Financial Stability Board, <http://www.fsb.org/wp-content/uploads/R270617.pdf>

Deloitte.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as “Deloitte Global”) does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the “Deloitte” name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.

Copyright © 2017 Deloitte Development LLC. All rights reserved.

CENTER *for*
REGULATORY
STRATEGY
AMERICAS