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Office of the Comptroller of the Currency
U.S. Department of the Treasury
Washington, D.C.

Submitted electronically to innovation@occ.treas.gov

Regarding: Solicitation of Public Input on “Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective”

To Whom It May Concern:

We are responding to the request for public input contained in the white paper issued by the Office of the Comptroller of the Currency (“OCC”) in March 2016 titled “Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective” (which we refer to herein as the “White Paper”). As requested, we are providing overall comments on the subjects raised in the White Paper in the body of this letter and also addressing many of the specific questions posed therein. Where appropriate, we also provide specific recommendations that policymakers may want to consider.

Alliance Partners LLC (“Alliance Partners”) advises a network of more than 200 community bank members across the country, empowering them to serve their business and consumer customers with products and services they are typically no longer able to efficiently offer on their own. Through BancAlliance Inc. (“BancAlliance”), a collaborative, community bank-controlled network composed of more than 200 regulated institutions, we are able to pool the individual capacity of each bank in the network to generate the collective scale necessary to deliver product and service solutions that support the mission and purpose of community banks in a manner consistent with regulatory expectations. Please note that the views expressed herein are solely those of Alliance Partners and do not necessarily reflect the views of our community bank clients.

We believe we have a perspective on the issues raised in the White Paper resulting from our role as an advisor to the community banks that make up the BancAlliance network. BancAlliance is designed to empower community banks to, once again, be successful in lines of business that have been challenging for smaller banks on their own, largely due to issues of scale. To achieve this objective, the network capitalizes on its collective scale through collaborative solutions.

The community banks we serve have identified as priorities for our efforts smaller balance lending such as consumer and small business lending where technology is a critical component of competitiveness and customer service. Given the important role of fintech firms in consumer and small business lending and the related needs of BancAlliance member banks, the opportunities in the fintech space were

readily apparent, and the network directed Alliance Partners to identify and evaluate such opportunities.

In that capacity, we have: i) met with and assessed more than 100 fintech firms as potential partners for community banks, ii) structured fintech partnerships for the banks we serve across both consumer and small business lending, iii) facilitated diligence by the banks on fintech partners in conformity with regulatory expectations including third-party vendor management guidance, iv) managed and monitored such active partnerships for the benefit of BancAlliance member banks, and v) continue to seek additional fintech partnerships that make sense for our member banks.

Based on that experience and perspective, we believe:

1. *Community banks are a critical part of the American financial system but face significant competitive challenges.*

- There are more than 5,500 community banks (defined as banks with less than \$10 billion in assets) with an aggregate of \$2.7 trillion in assets.
- Community banks are uniquely well positioned to serve their customers, with high levels of customer satisfaction and low cost, low risk capital. For instance, community banks typically earn net promoter scores – a measure of customer satisfaction – that are multiples of the statistics for larger banks.
- However, over the past few decades, a number of lines of business have become process- and technology-intensive, including consumer and small business lending.
- Historically, the fixed costs associated with developing, implementing and managing technology solutions were large which left community banks without competitive lending platforms in these process- and technology-intensive lines of business.
- As a result, community banks independently often lack the scale to offer a full range of products and services. For instance, a large number of community banks have exited consumer lending resulting in a shift of their consumer loan market share from 70% to less than 8% since 1990, with the largest banks grabbing that lost business.
- The larger banks that have controlled scaled platforms for these lines of business have typically not been interested in mutually beneficial partnerships that might allow community banks shared access to those required capabilities.
- The result has been an increase in the concentration of the loan portfolios of these banks in the lines of business (especially in commercial real estate) where the traditional community bank approach to the market has remained competitive.

2. *Fintech appears to be targeting precisely the lines of business in which community banks have struggled to compete.*

- Fintech is essentially the application of new systems and customer interfaces to banking products and services. As a result, fintech lending ventures are focused on the process- and technology-intensive lines of business such as consumer and small business that have proven challenging for community banks on their own.
- Fintech solutions offer the proven potential to dramatically reduce the unit costs and time required to gather information to underwrite a loan application while simultaneously improving the customer experience. This should expand access to credit and improve the consistency and rigor of underwriting.

- Fintech also offers proven potential to enhance quality control, KYC and fraud management processes.
- 3. *While fintech capabilities will be enduring and transformative, a large number of fintech ventures will inevitably fail.***
- Like other waves of innovation, the potential value of these fintech developments has spawned a large number of new ventures with wildly differing approaches to the market.
 - As was the case in the dot-com boom of the late 1990s, many of these ventures will fail or be acquired as the winning firms and business models emerge.
 - This rationalization process will be noisy and is not without risk, but ultimately will be healthy for the financial services sector and the customers it serves.
 - The inevitability of a large number of firm failures makes partner selection (including financial strength and resources) and ongoing monitoring critically important.
- 4. *Banks generally have several options to respond to fintech developments, but the options are much more limited for community banks.***
- Larger banks can choose to ignore (i.e. to hope this is a passing trend), buy, build or partner.
 - Community banks typically lack the scale to buy or build. As a result, if a community bank seeks to respond to and capitalize on innovation such as fintech, partnership is the only viable option.
- 5. *An intriguing aspect of fintech is the disaggregation of the lending value chain, which may work to the benefit of community banking.***
- Technology and interfaces such as APIs increasingly enable the disaggregation of business processes including those related to lending. This allows different firms to focus on specific components of the overall business process and can free each from the obligation to be competitive in all of the components.
 - Allowing various partners in the business process to each do what they do best, without requiring them to also perform functions they may not be best suited to handle, can deliver significant benefits to customers by expanding the range and quality of the options available.
 - For community banks, this is a critical characteristic of fintech. Historically, with the lending value chain aggregated under one roof, community banks were not able to capitalize on their strong customer relationships and low cost capital because they lacked the scale to compete in other parts of the lending process (e.g. to hire hundreds of professionals or invest in complex technology systems to operate servicing or origination platforms).
 - The opportunity to partner with other market participants with complementary capabilities holds the promise to empower community banks to again be competitive in a full range of lending products and services.
 - However, such partnerships require a high level of negotiation, structuring, diligence and ongoing monitoring that can be daunting for individual community banks.
- 6. *Many fintech firms are focused on forging partnerships with banks and in particular with community banks.***
- Fintech firms excel at systems development and process reengineering with a focus on efficiency and best-in-class customer experience. However, these firms typically lack preexisting customer relationships as well as the ability to access low cost capital.
 - Banks, and community banks in particular, excel at customer service, have preexisting trust-based customer relationships and enjoy unparalleled low cost, low risk capital. However,

community banks typically lack the capability to deploy process- and technology-intensive solutions that enable superior customer experience and efficient lending operations.

- While a number of fintech firms launched with the stated intent to disintermediate and replace banks, many have come to recognize the compelling logic of partnership and have reoriented their business towards bank partnerships.

7. *Fintech/community bank partnerships, if carefully structured and monitored, offer significant potential benefits for community banks and the customers and communities they serve.*

- Absent partnerships, community banks will likely continue to be uncompetitive in process- and technology-intensive lines of business.
- By capitalizing on partnerships, community banks can offer their customers a full range of best-in-class products and services, expand access to credit, improve their profitability and reduce risk through diversification.
- As a consequence of third-party vendor management expectations, partnerships between banks and fintech firms offer the ancillary benefit of indirectly subjecting the fintech sector to a greater level of regulatory scrutiny which, in turn, contributes to a more level playing field.
- Diligence and monitoring is essential to ensure such partnerships are sustainable and consistent with the integrity and customer focus that community banks appropriately demand. We note that controls and monitoring (whether internal to the partner or undertaken by one or more of its bank partners) are critically important both to preventing most issues and, equally important, identifying and rectifying those issues that do occur.

8. *With respect to the guiding principles outlined in the White Paper, we offer the following observations:*

- We concur with the guiding principles set forth in the White Paper.
- We strongly support the commitment to foster innovation for banks of all sizes. Given the challenges facing the community banking business model and the promise of the trends behind fintech for that model, the potential benefits of prudent innovation are likely to be substantial.
- We would similarly underscore the critical importance of establishing the desired culture and clearly communicating guidance internally, given the potential for individual examiners to adopt varying approaches to the issues involved. In our experience, it is not unusual in regulatory interactions for anything new (or innovative) to be implicitly equated to risky. Such perspectives can create a bias towards inaction. Particularly during periods of innovation, inaction may well be riskier than action. The potential chilling effect of such perspectives and inconsistencies tends to impact community banks disproportionately.
- We suggest that, both in terms of internal consistency and across agencies, the OCC focus on identifying and resolving regulatory uncertainties and inconsistencies wherever possible. Uncertainty, in particular, can stifle innovation.

9. *With respect to the questions specified in the White Paper, we offer the following observations:*

- Challenges facing community banks with regard to emerging technology and financial innovation:
 - As outlined above, we believe that community banks are well positioned to benefit from fintech innovation. To achieve these benefits, however, community banks must forge prudent partnerships with appropriate fintech partners.

- To forge such partnerships, an individual community bank would struggle to gain the focus and attention of the best potential partners and may lack negotiating leverage to structure optimal arrangements.
- Similarly, an individual community bank would face significant upfront and ongoing costs (in terms of staff time, travel, legal, consulting and other expenses) related to satisfying third-party vendor management expectations.
- Our experience is that these costs can be substantial and create a scale-based barrier to the creation of partnerships.
- Options to facilitate responsible innovation by institutions of all sizes:
 - As outlined above, larger banks have a broad range of options to respond to fintech innovation.
 - For community banks to be able to capitalize on the promise of this innovation and enhance the affordability of and access to capital for their customers, it is essential that the partnership path, if executed well and prudently, is perceived by banking regulators as a responsible form of innovation.
 - Prudent execution of such partnerships requires (substantively and in order to satisfy regulatory expectations) intense levels of diligence and monitoring. The investment required to maintain appropriate diligence and monitoring may be unsupportable for a community bank on its own.
 - It is therefore critical that community banks have access to collaborative approaches to such partnerships that pool the resources of a number of banks. Collaboration can result in increased negotiating power (and thus better partnership terms), can reduce the per bank costs of vendor management by sharing those costs, can improve the quality of vendor management oversight by ensuring each bank has access to best-in-class experts, and can mitigate the scale barrier to partnerships that might otherwise prevent community banks from responding to innovation in a way that benefits their communities.
 - We note that collaboration among community banks can take a number of forms, including the BancAlliance network that we serve. However, collaboration can also be beneficial among community banks and larger banks. For instance, BancAlliance is exploring the possibility of collaborating with a large regional bank in an effort to coordinate vendor management diligence and oversight in connection with a small business partnership. Encouraging such collaboration should be a priority for the regulatory agencies.
 - Collaboration and coordination can have benefits for the OCC (and other regulatory agencies) and for the fintech partner by reducing the extent of duplicative information and interactions. Duplicative regulatory and compliance audits by a third-party expert are costly and time consuming for all involved.
 - The OCC and other agencies may want to consider more formal means by which to share diligence and monitoring information throughout the banking system to improve oversight and reduce costs. In some cases, it may be appropriate to evaluate certain fintech partners pursuant to the Bank Service Company Act or to take a “pooled” approach to vendor management information and assessments analogous to the Shared National Credit program.

- Revisions to existing guidance to support responsible innovation:
 - Increased clarity regarding the regulatory frameworks within which loans are originated and serviced by fintech firms would benefit the financial system and customers. For instance, certain legal opinions such as that in the *Madden* case have called into question the validity of the bank partnership approach to loan origination that is used by most fintech consumer lenders. Our view has been that the bank partnership approach to loan origination is constructive in that it subjects nonbank lenders to a level of indirect regulatory oversight and provides a consistent, nationwide framework within which to assess the lending partner. To the extent possible, resolving such uncertainties and establishing clear expectations for these fundamental business model questions would support responsible innovation.
 - The OCC and other agencies may want to consider action to ensure appropriate borrower disclosures and protections are in place with regard to small business lending. While the rules governing consumer lending are robust regardless of whether the lender is a bank or a nonbank firm, small business nonbank lenders are generally not subject to the same requirements and expectations as a bank in that market. In that light, we note that Alliance Partners was an early signatory of the Small Business Borrower Bill of Rights which is designed as a set of best practices consistent with a prudent and efficient small business loan market and includes provisions relating to brokerage arrangements.
 - The OCC may want to consider expanding on its existing White Paper on collaboration to address fintech specifically, both to incorporate the points made above and to underscore the potential benefits of such collaborative approaches to innovation for community banks. This could also serve to advance the OCC's guiding principle regarding fostering an internal culture receptive to responsible innovation.
 - It may be appropriate for the OCC to consider expanding on its vendor management guidance to clarify the extent to which a bank (and in particular a community bank) may rely on collaborative approaches to vendor management.

We appreciate the opportunity to share our perspectives on these important developments in financial services and are available to the extent you have questions or desire to discuss these matters further.

Sincerely,

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Briah Graham
Chief Executive Officer