DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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SMALL BANK PARTNERSHIPS WITH FINTECHS FACING INCREASED SCRUTINY

On August 29, 2022, Blue Ridge Bank ("Bank"), which has $2.8 billion in assets, entered into a formal written agreement with the Office of the Comptroller of the Currency ("OCC") regarding the Bank's oversight of its fintech partners. The OCC found unsafe and unsound practices relating to Bank oversight of third-party risk, Bank Secrecy Act/Anti-Money Laundering risk management, suspicious activity reporting and information technology control and risk governance.

The OCC enforcement action agreement requires the Bank to take certain steps to improve third-party oversight and risk management, including the establishment of a majority-independent Compliance Committee, which must be approved by the Assistant Deputy Comptroller. Additionally, the Bank must adopt and implement a written program to assess and manage the risks posed by fintech partnerships, taking into consideration previous OCC guidance on community bank partnerships with fintechs. The Bank must also obtain OCC non-objection prior to onboarding new fintech partners or offering new products or services with existing fintech partners.

This enforcement action agreement comes as regulators signal that smaller banks should expect closer regulatory scrutiny of their fintech partnerships. In remarks before the Texas Bankers Association on September 1, 2022, Acting Comptroller of the Currency Michael Hsu said that while the OCC will encourage examiners to be "open-minded" to new and innovative approaches to meeting safety and soundness expectations, community banks should follow the OCC's 2021 guidance on the need to conduct appropriate due diligence on fintechs, particularly those with limited history. Finding an appropriate balance between respecting the need for innovation and protecting bank customers from excessively risky innovation that could threaten safety and soundness means that regulators cannot "simply adopt a lighter supervisory approach and expect less from community banks", according to Acting Comptroller Hsu. Instead, it will require "enhanced engagement".

The OCC is not the only regulator paying close attention to bank partnerships with fintechs. In July 2021, the Federal Reserve, Federal Deposit Insurance Corporation ("FDIC") and OCC proposed an interagency guidance on managing risks associated with bank relationships with third-parties, like fintechs. While the guidance has not yet been finalized, the collaboration of three federal regulators on a guidance regarding risk management in bank-fintech partnerships indicates that banks should expect closer scrutiny of their partnerships, regardless of their regulator.

Scrutiny of small bank partnership relationships is not new. A number of consent orders have been issued by the OCC and FDIC since the early 2000s addressing both unfair and deceptive acts and practices and safety and soundness claims against smaller banks that have been criticized for inadequate supervision and control over products, programs and partners.

Bank-fintech partnerships are a common tool to accomplish fintech goals and provide innovative products and services to consumers but need adequate bank involvement and due expertise, particularly when such banks expand from local service areas to nationwide programs with nationwide compliance requirements.

In light of enhanced scrutiny, it is even more important that partnerships be structured properly with appropriate bank oversight. We can advise on the proper structure for bank partnerships, as well as any policies that may be necessary to ensure that products, programs, partners and various risks are managed appropriately. ❑

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