

Call For Input Shows How Banks, Fintechs Can Address Risks

By **Jeremy McLaughlin, Grant Butler and Andrew Glass** (November 7, 2024)

Bank-fintech partnerships have become a useful tool for banks to leverage new technology to offer better or more efficient services. and to expand into new markets.

But since their inception, these partnerships have always imposed heightened concerns for regulators about safe and sound banking practices and consumer financial protection. Among other things, the relatively recent failure of several large banks, plus fintech middleware provider Synapse Financial Technologies Inc., caused federal banking regulators to issue a July 25 request for information, or RFI, seeking additional information about these partnerships.[1]

This article does not purport to provide answers for the regulators. Rather, we have analyzed the RFI issued by the U.S. Department of the Treasury's Office of the Comptroller of the Currency, the Federal Deposit Insurance Corp. and the Federal Reserve Board to identify some issues at the heart of the regulators' concerns.

We aim in this article to provide some practical considerations and recommendations for banks and fintech companies to help them avoid regulatory scrutiny.

Mitigating Potential Risks in Bank-Fintech Relationships

The rapid growth in banking activity — resulting from bank-fintech partnerships and from expanding opportunities to capture market share through greater access to data in an open banking environment and through the use of artificial intelligence tools — has led to a concomitant increase in operational complexity.

Businesses should consider building governance teams, with members from their legal, compliance, risk management and technology departments, along with other stakeholders, to understand the scaling and operational risks presented by implementing new technologies.

Governance teams should consider, for example, outlining the various types of risks — and appropriate responses to those risks — presented by expanded market share, obtaining data on a larger scale, and the need to access data held by third parties to meet regulatory and litigation obligations. The teams should also consider implementing policies for managing vendor relationships, such as obtaining warranties from vendors that they will comply with applicable law, providing results of their fair-lending testing and facilitating access to data belonging to the financial institution.

Additionally, governance teams should consider implementing policies for compliance with fair lending and credit reporting obligations. A significant area of focus for lending institutions that expand market share through the use of fintech products is the potential for the use of new or alternative data sources to make credit decisions to have unintended impacts on fair lending.



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For instance, banks may receive types of data different from traditional credit histories. This data may track consumers' ability to meet noncredit financial obligations, but also may track their behavior in the marketplace, such as where they shop or how they interact with the social media sphere.

Risks arise from the Consumer Financial Protection Bureau's pronouncement that banks must understand and explain during supervisory exams how vendor algorithms work, including the types of data inputs those algorithms use and the impact the use of algorithms has on consumers.

The CFPB has also stated that it will consider third-party vendors that provide material support to a regulated entity's business activities to be within the CFPB's purview. Thus, all businesses, from banks to fintechs, should consider implementing procedures for conducting regular fair-lending testing for potential disparate impact on protected groups of individuals.

Similarly, the expanded use of consumer data, which the CFPB's open banking rule finalized in October will likely facilitate,[2] suggests that businesses develop policies and procedures for responding to an increased volume of credit disputes and disputes that may result from the use of different types of data points.

Finally, smaller entities often face challenges in bargaining for contractual rights to test and obtain necessary data. Thus, businesses may consider advocating for a regulatory regime where all ecosystem participants have a duty to share information sufficient to allow participants to meet their regulatory obligations.

Specific Risks of Deposit Products

Fintechs must partner with banks to offer deposit products, such as checking and savings accounts, given that only banks have the legal authority to accept deposits. These types of partnerships give rise to specific operational and compliance risks.

For example, a successful deposit partnership can result in rapid balance-sheet growth for banks. To avoid being a victim of its own success, the partner bank must monitor the expanding balance sheet to manage liquidity risk and ensure there is adequate liquidity when fintech-generated deposits are used to fund longer-term or illiquid assets.

Rapid growth in fintech-sourced deposits may also result in concentration of funding, which must also be closely managed from a risk and safety-and-soundness perspective. Fintech-sourced deposits may also be more sensitive to interest rates; the bank partner should consider the stability of the funding in different interest rate environments.

A bank-fintech partnership involving deposit products requires careful and accurate disclosure of deposit insurance coverage. The FDIC has expressed concerns about deposit insurance statements by nonbank third parties that may create customer confusion about when deposit insurance is available to protect customer deposits, such as in the event of the failure of the bank but not the failure of the nonbank third party. The FDIC has issued numerous enforcement orders in the last year to entities for making misleading statements regarding deposit insurance.

The FDIC, OCC and Fed are focused on the risks attendant to bank-fintech partnerships that deliver deposit products. In conjunction with the RFI, the three banking agencies published a second document, "Joint Statement on Banks' Arrangements with Third Parties

to Deliver Bank Deposit Products and Services.”[3] The joint statement enumerates various risks relating to deposit partnerships — both general risks that arise in most fintech partners and some of the specific risks for deposit relationships, such as those highlighted above.

The joint statement provides guidance on regulators' risk management expectations regarding such products. These should be carefully reviewed by any bank or fintech partnering to deliver deposit products.

Deposit products offered by fintech companies in partnerships with banks may also be affected by the FDIC's recently proposed revisions to the regulations related to brokered deposits.[4] If adopted as proposed, the revisions may result in deposits sourced from fintech companies that are not currently considered brokered deposits being deemed brokered deposits.

The Synapse bankruptcy has also highlighted the risks of relying on third parties to manage deposit records for omnibus deposit accounts placed with banking partners.

Following the bankruptcy, Synapse's banking partners encountered significant difficulties in obtaining, reviewing and reconciling Synapse's records, and have raised concerns about the accuracy of the records. This has resulted in customers being unable to access their deposits.

In response to these issues, the FDIC proposed a rule requiring banks to maintain records relating to custodial deposit accounts and reconcile account balances daily.[5] If a bank wishes for deposit account records to be maintained by a third party, such as its fintech partner, it must have direct, continuous and unrestricted access to the records of the beneficial owners, and the deposit records of the third party must be independently validated on an annual basis.

Understanding and Managing the Customer Relationship

In most bank-fintech partnerships, the consumer typically first engages the fintech company to provide a particular service, but partnerships can vary greatly regarding whether the consumer ultimately is a customer of the bank, the fintech company or both.

This determination is important, however, to better understand who will market services during the relationship, access and use customer data, and generally own the customer during and after the relationship. For this reason, the bank and fintech company should discuss these issues at the outset of the relationship to help avoid future disputes and uncertainties.

Aside from the details of the partnership, the consumer themselves may not be immediately aware of the bank's role or whether they are a customer of the bank. For this reason, it's important for the bank and fintech company to ensure there are clear and obvious disclosures about the role of each entity.

Banks should review all marketing materials, customer-facing mobile apps and websites, end user agreements, disclosures, onboarding policies and procedures, customer service scripts, error resolution procedures, and other consumer-facing materials. This extends to social media ads and posts as well. The fintech company must clearly disclose that it is not a bank and that the banking services are being provided by the banking partner.

Customer Complaints

Customer complaints should be a particular area of concern.

The fintech company will typically be responsible for handling these, but the bank should monitor this process closely because it will usually be the party ultimately responsible for the program. There should be established policies and procedures for addressing complaints, including time frames; escalation procedures; policies to ensure compliance with Regulation E and Regulation Z, as applicable; and so on.

The policies should also take into account the source of the complaint, which could be the end user, a consumer who is not a current customer, the Better Business Bureau, the CFPB or some other regulatory authority.

The fintech company should also be required to communicate consumer complaints to the bank in a timely manner, especially regarding critical compliance issues, and to maintain a complaint log. If there is a rise in complaints, whether as to a specific component of the service, or generally, this needs to be communicated to the bank so issues can be resolved in a timely manner. The bank needs the ability to require changes to the program.

Understanding and anticipating regulatory concerns in advance is a critical process that both banks and fintech companies must take to avoid damaging regulatory entanglements.

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[1] Request for Information on Bank-Fintech Arrangements Involving Banking Products and Services Distributed to Consumers and Businesses (July 31, 2024), available at <https://www.govinfo.gov/content/pkg/FR-2024-07-31/pdf/2024-16838.pdf>.

[2] Required Rulemaking on Personal Financial Data Rights (Oct. 22, 2024), available at https://files.consumerfinance.gov/f/documents/cfpb_personal-financial-data-rights-final-rule_2024-10.pdf.

[3] Joint Statement on Banks' Arrangements with Third Parties to Deliver Bank Deposit Products and Services (July 25, 2024) available at https://www.fdic.gov/system/files/2024-07/joint-statement-on-third-party-deposit-products_0.pdf.

[4] FDIC Notice of Proposed Rulemaking: Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 89 FR 68244.

[5] FIL-64-2024 Requirements for Custodial Deposit Accounts with Transactional Features and Prompt Payment of Deposit Insurance to Depositors (Sept. 17, 2024).