

September 15, 2021

Community Bank Access to Innovation Through Partnerships

Federal Reserve Publishes Additional Guide for Community Banks

SUMMARY

On September 9, 2021, closely following the publication of an interagency guide to conducting due diligence on financial technology (“fintech”) companies, the Federal Reserve published an additional guide for community banks.¹ The Federal Reserve’s guide similarly addresses possible benefits, risks and challenges of partnerships between fintech companies and community banks, but places more emphasis on the types of possible partnerships involved and broad considerations for effective collaboration.

NEW GUIDE FROM THE FEDERAL RESERVE EMPHASIZES THE IMPORTANCE OF INNOVATION

On September 9, 2021, the Board of Governors of the Federal Reserve System issued a new guide, aimed at community banks, discussing (1) broad partnership types between community banks and fintech companies to facilitate innovation; and (2) key elements of successful partnerships, as informed by engagements with a variety of outreach participants. The Federal Reserve emphasized that, although the guide is intended to serve as a resource for community banks contemplating partnerships with fintech companies for responsible innovation, the guide does not establish new, or interpret existing, guidance related to third-party risk.²

The Federal Reserve’s guide first addresses the benefits, risks and challenges of three broad types of fintech partnerships: (1) operational technology partnerships; (2) customer-oriented partnerships; and (3) front-end fintech partnerships. Operational technology partnerships involve improvements to internal systems aimed at bank processes, monitoring capabilities or technical infrastructure, and may not be visible to customers. Relevant partnerships could, for example, involve technologies intended to improve a bank’s fraud detection capabilities or ability to comply with Bank Secrecy Act/Anti-Money Laundering

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requirements. One of the primary challenges the guide identifies with this kind of partnership is the need for the bank to develop new types of expertise, such as hiring new staff with knowledge of a specific software and the software's related platforms.

By contrast, in customer-oriented partnerships, fintechs are engaged to help enhance the ability of community banks to address the customer-facing aspects of their business. For example, the guide notes that, in conversations with the Federal Reserve, bankers noted the importance of a customer-friendly digital banking environment in the context of the COVID-19 pandemic. Community banks may also seek to work with new fintech partners with the ability to integrate within the bank's existing customer-facing platforms, to avoid the potentially disruptive experience of having customers visit different digital platforms for different kinds of information.

Finally, front-end fintech partnerships allow fintechs to interact directly with customers in providing banking products and services offered by the community bank, an evolving business approach sometimes referred to as "Banking-as-a-Service." Although this type of partnership can bring many benefits, such as the ability to reach new segments of a population or new geographies, it can also pose heightened third-party risk because the fintech partner "essentially acts as an extension of the bank from the perspective of the end-consumer."

The guide then addresses three important considerations for establishing effective partnerships between fintechs and community banks: (1) commitment to innovation; (2) thoughtful approach to connectivity; and (3) alignment in priorities and objectives. In seeking new fintech partnerships to spur innovation, participants in the Federal Reserve's outreach noted that identifying the specific gains a community bank wishes to realize from technology is critical. And though many fintechs may have the ability to bring innovative technology to community banks, improving bank technology may require a shift in mindset, particularly when gains from a new resource-intensive endeavor may not be seen immediately. The Federal Reserve also emphasized that bankers generally prefer partnering with fintechs that understand what it means to be a fiduciary and a financial services partner, with particular weight given to the importance of compliance with banking regulations. Banking experience and expertise at fintech partners is, according to the guide, regarded positively by many community bankers.

IMPLICATIONS

The Federal Reserve's guide is the latest to address the growing collaboration between community banks and the fintech sector, while emphasizing both the potential benefits of innovation and the potential risks and challenges that should be kept in mind when establishing new partnerships.

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ENDNOTES

- ¹ *Community Bank Access to Innovation Through Partnerships*, FEDERAL RESERVE (Sept. 9, 2021), available at <https://www.federalreserve.gov/publications/files/community-bank-access-to-innovation-through-partnerships-202109.pdf>.
- ² The same agencies recently released proposed interagency guidance and a request for comment relating to risk management in third-party relationships; the comment period remains open. See Proposed Interagency Guidance on Third-Party Relationships: Risk Management, 86 Fed. Reg. 38,182 (July 19, 2021) (proposed interagency guidance and request for comment); 86 Fed. Reg. 50,789 (Sept. 10, 2021) (extending the comment period to Oct. 18, 2021).

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