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# Regulatory Guidance Regarding FinTech Products and Services

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## OCC White Paper and New CFPB Policy Clarify Regulatory Expectations for Financial Institutions and Other Market Participants

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### SUMMARY

On March 31, 2016, the Office of the Comptroller of the Currency (the “OCC”), the regulator of federally chartered national banks and savings associations, released a white paper that sets forth the OCC’s perspective on supporting responsible innovation in the federal banking system (the “White Paper”).<sup>1</sup> The release of the White Paper represents the most significant effort by a U.S. federal financial regulator to provide guidance for financial institutions and companies regarding the development of products and services in the financial technology (“FinTech”) sector and identifies the principles that the OCC plans to use as it continues to develop its comprehensive framework for understanding and evaluating innovative products, services and processes.

The release of the White Paper follows the publication, on February 18, 2016, by the Consumer Financial Protection Bureau (the “CFPB”) of its final policy to facilitate consumer-friendly innovation (the “CFPB Innovation Policy”). The CFPB Innovation Policy, which was first proposed in October 2014, establishes a new process for financial institutions and companies to apply for No-Action Letters regarding the application of consumer regulations to new products that offer the potential for significant consumer-friendly innovation.<sup>2</sup> Through this new process, the CFPB intends to permit financial institutions and companies to clarify regulatory uncertainty during the FinTech product development process.

Together, the White Paper and the CFPB Innovation Policy provide financial institutions and companies with important guidance regarding the federal financial regulators’ evolving attitudes towards innovation in the FinTech sector.

## BACKGROUND

The FinTech sector has witnessed a significant increase in interest and activity over the past few years, fueled by the rising demand for new products and services by consumer and business customers and the rapid development of innovative offerings designed to meet these needs. While banks and other types of regulated financial institutions have been active participants in the development of the FinTech sector, new types of un-regulated and lightly regulated market participants, including both established technology companies and newer startups, have also gained significant traction. This increase in interest and activity has been facilitated by a surge in financial resources, as investment in the FinTech sector has risen from \$1.8 billion in 2010 to \$19 billion in 2015,<sup>3</sup> as well as by the increased focus on the development of broadly available faster payment mechanisms.<sup>4</sup>

FinTech companies have begun to challenge banks and other types of regulated financial institutions across a broad range of products and services. In the mobile payments space, service providers including PayPal, Ripple, Square, Venmo and Apple Pay are changing the ways in which retail and business customers pay for purchases, facilitated by rapid advances in mobile phone hardware and software.<sup>5</sup> In the lending space, “marketplace” and “peer to peer” lenders including SoFi, Lending Club and Prosper provide increasing numbers of retail and commercial borrowers with alternatives to loans sourced from traditional banks.<sup>6</sup> In the market infrastructure sector, new service providers such as Digital Asset Holdings are using advances in distributed ledger technology to provide market participants with new methods of clearing and settling transactions.<sup>7</sup>

Despite this increase in activity, financial regulators have only recently begun to address the challenges posed by these new forms of innovation. In the U.K., the Financial Conduct Authority (“FCA”) recently launched a new initiative named “Project Innovate” to help companies work with British financial regulators to launch innovative financial products in the market. In connection with this initiative, the FCA is currently working to develop a “sandbox” model to allow FinTech companies to test new products under the FCA’s regulatory supervision.<sup>8</sup> In the U.S., the most significant regulatory actions to date have been at the state level,<sup>9</sup> including the adoption of “BitLicense” regulation by the New York State Department of Financial Services in 2015.<sup>10</sup>

At the federal level in the U.S., the White Paper represents the most significant effort by a financial regulator to communicate its perspective regarding how FinTech products and services will be regulated. The CFPB Innovation Policy, while more limited in scope and objective, also provides regulated financial institutions and other market participants with an important channel to determine whether new consumer-focused products are likely to receive favorable regulatory treatment.

## WHITE PAPER

In August 2015, Comptroller of the Currency Thomas J. Curry announced an initiative to develop a comprehensive framework to improve the OCC's ability to identify and understand trends and innovations in the financial services industry, as well as the evolving needs of financial services consumers. The development of this comprehensive framework is intended to improve the manner in which the OCC evaluates innovative products, services and processes and the risks associated with them. It is also meant to clarify lines of communication between the OCC and the financial industry regarding emerging technology and new products, services and products.<sup>11</sup>

In the White Paper, the OCC explains that encouraging "responsible innovation" is central to its mission to ensure that national banks and federal savings associations operate in a safe-and-sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. The OCC defines "responsible innovation" to mean "the use of new or improved financial products, services, and processes to meet the evolving needs of consumers, businesses, and communities in a manner that is consistent with sound risk management and is aligned with the bank's overall business strategy."<sup>12</sup> The White Paper identifies a set of eight principles that guide the OCC's approach to responsible innovation, which are collectively intended to facilitate the ongoing development of the OCC's comprehensive framework.<sup>13</sup>

The eight principles set forth in the White Paper are the following:

***Support responsible innovation:*** The OCC is considering various reforms to improve its process for understanding and evaluating innovative financial products, services, and processes. As part of this process, the OCC will evaluate its guidance on new product development and third-party risk management and assess whether additional guidance is appropriate to address the needs of banks and their customers in the rapidly changing environment. To expedite decision making, the OCC is also evaluating whether it can streamline some of its licensing procedures, where appropriate, or develop new procedures where existing procedures may not work for certain innovative activities. In addition, the OCC is considering the possibility of creating a centralized office on innovation which could serve as a forum to vet ideas before a bank or nonbank makes a formal request or launches an innovative product or service.

***Foster an internal culture receptive to responsible innovation:*** The OCC will evaluate its policies and processes, define roles and responsibilities with respect to evaluating innovation, identify and close knowledge and expertise gaps, and enhance its communication with internal and external stakeholders. In addition, the OCC will develop or augment existing training to reinforce its receptiveness to responsible innovation and develop additional expertise to evaluate the opportunities and risks related to specific types of innovation.

***Leverage agency experience and expertise:*** The OCC will rely heavily on the breadth and depth of knowledge of its existing staff in implementing its responsible innovation framework, and will consider designating lead experts on responsible innovation who could support the OCC's bank supervision staff and provide advice based on a broad view of innovation trends and developments across the federal banking system.

***Encourage responsible innovation that provides fair access to financial services and fair treatment of consumers:*** To encourage responsible innovations that provide fair access to financial services and fair treatment of consumers, the OCC may issue guidance on its expectations related to products and services designed to address the needs of low- to moderate-income individuals and communities and may encourage innovative approaches to financial inclusion by promoting awareness of activities that could qualify for Community Reinvestment Act consideration.

***Further safe and sound operations through effective risk management:*** The OCC's framework will consider how national banks and federal savings associations identify and address risks resulting from emerging technology, including cybersecurity risk. The White Paper states that banks of all sizes should ensure that effective corporate governance and risk management meet supervisory expectations when considering new products, services, and processes. This includes expectations described in existing OCC guidance related to strategic planning, evaluating new products and services, using models, operational risk, cybersecurity, and managing third-party relationships.

***Encourage banks of all sizes to integrate responsible innovation into their strategic planning:*** According to the White Paper, a bank's decision to offer innovative products and services should be consistent with the bank's long-term business plan rather than following passing trends, and collaborations with nonbanks to offer innovative products and services should take into consideration whether such partnerships help the bank achieve its strategic objectives.

***Promote ongoing dialogue through formal outreach:*** The OCC plans to bring together banks, nonbanks and other stakeholders through a variety of forums, workshops and meetings to discuss responsible innovation. The OCC also intends to host "innovator fairs" to bring together banks and nonbank innovators with OCC experts to discuss regulatory requirements and supervisory expectations in the financial services industry.

***Collaborate with other regulators:*** The OCC will work with other regulators, such as the CFPB, to collaboratively support responsible innovation in the financial services industry. As part of this collaborative process, the OCC expects to use best efforts to avoid inconsistent communications with supervised entities.

The OCC has requested feedback on all aspects of the White Paper. Comments must be submitted by May 31, 2016.

## CFPB INNOVATION POLICY

Originally proposed in October 2014, the CFPB Innovation Policy was created as part of the CFPB's Project Catalyst initiative, which is designed to encourage consumer-friendly developments in markets for consumer financial products and services, and is viewed by the CFPB as an important aspect of fulfilling its mandate under the Dodd-Frank Wall Street Reform and Consumer Protection Act to provide all consumers access to fair, transparent, effective, and innovative markets. In a press release accompanying its publication, the CFPB explains that the CFPB Innovation Policy is intended to enhance regulatory compliance in specific circumstances where a product promises significant consumer benefit and where there may be uncertainty around how the product fits within an existing regulatory scheme.<sup>14</sup>

To facilitate this enhanced level of compliance, the CFPB Innovation Policy establishes a new process through which companies can apply for a No-Action Letter from the CFPB staff to clarify regulatory uncertainty regarding a new product that is under development. By providing a dedicated channel through which substantial regulatory uncertainty can be reduced, the CFPB Innovation Policy is also intended to discourage the offering of new products that may be innovative but harmful to consumers. Requests for No-Action Letters submitted through this process are required to meet a set of substantive criteria set forth in the CFPB Innovation Policy, which include (i) an explanation on how the product is likely to provide substantial benefit to consumers, (ii) a candid explanation of potential consumer risks posed by the product (and undertakings by the requester to address and minimize such risks), and (iii) a showing of why the requested No-Action Letter is necessary and appropriate to remove substantial regulatory uncertainty hindering the development of the product.<sup>15</sup>

Depending on the facts and circumstances regarding a particular request, the CFPB staff may either (i) grant the request, (ii) deny the request, (iii) specifically decline to either grant or deny the request, with an explanation, or (iv) specifically decline to either grant or deny the request, without explanation. When the CFPB staff decides to provide a No-Action Letter to a requester, its contents are expected to include a statement that, subject to the conditions and limitations set forth therein, the CFPB staff has no present intention to recommend initiation of an enforcement or supervisory action against the requester in respect of the particular aspects of its product under the specific identified provisions and applications of statutes or regulations that are the subject of the No-Action Letter. No-Action Letters issued by the CFPB staff will be non-binding on the CFPB, will not be a waiver of any law or regulation, and will not give a requesting entity an exemption from complying with any statutory or regulatory rules.<sup>16</sup>

The CFPB anticipates that No-Action Letters will be provided rarely, on the basis of exceptional circumstances and following a thorough and persuasive demonstration of the appropriateness of such action. In considering whether to provide a No-Action Letter, the CFPB will take into consideration a number of criteria set forth in the CFPB Innovation Policy, including (i) the extent to which the product's purported benefits are already available in the marketplace from other products, (ii) the extent to which

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granting the request is necessary in order to reduce substantial regulatory uncertainty, and (iii) the extent to which the substantial regulatory uncertainty identified by the requester may be better addressed through other regulatory means, such as rulemaking or other guidance published by the CFPB.<sup>17</sup>

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ENDNOTES

- 1 OCC, *Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective* (Mar. 31, 2016), available at <http://occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf> (“White Paper”).
- 2 CFPB, *Policy on No-Action Letters* (Feb. 18, 2016), available at [http://files.consumerfinance.gov/f/201602\\_cfpb\\_no-action-letter-policy.pdf](http://files.consumerfinance.gov/f/201602_cfpb_no-action-letter-policy.pdf) (“CFPB Innovation Policy”).
- 3 Citi, *Digital Disruption: How FinTech is Forcing Banking to a Tipping Point* (Mar. 30, 2016), available at <https://ir.citi.com/SEBhgbdvxes95HWZMmFbjGiU%2FydQ9kbvEbHlruHR%2Fle%2F2Wza4cRvOQUNX8GBWVsV> (“Citi Report”).
- 4 See, e.g., Federal Reserve System, *Strategies for Improving the U.S. Payment System* (Jan. 26, 2015), available at <https://fedpaymentsimprovement.org/wp-content/uploads/strategies-improving-us-payment-system.pdf>.
- 5 See, e.g., Citi Report at 11, 43-45.
- 6 See, e.g., Citi Report at 61-63.
- 7 See, e.g., Citi Report at 89-95.
- 8 The Wall Street Journal, *Regulator Moves to Create New Fintech Framework* (Mar. 28, 2016), available at <http://www.wsj.com/articles/regulator-moves-to-create-new-fintech-framework-1459157401?mg=id-wsj>.
- 9 The Uniform Law Commission is developing a proposed uniform law to provide for regulation of blockchain currency-related service providers at the state level, including an “on-ramp” intended to facilitate experimentation by potential service providers without imposing the full range of regulatory requirements. See National Conference of Commissioners on Uniform State Laws, *Regulation of Virtual Currency Businesses Act*, available at [http://www.uniformlaws.org/Committee.aspx?title=Regulation of Virtual Currency Businesses Act](http://www.uniformlaws.org/Committee.aspx?title=Regulation%20of%20Virtual%20Currency%20Businesses%20Act).
- 10 “NYDFS Announces Final BitLicense Framework for Regulating Digital Currency Firms” (Jun. 3, 2015), available at <http://www.dfs.ny.gov/about/speeches/sp1506031.htm>.
- 11 White Paper at 3.
- 12 *Id.* at 5.
- 13 *Id.* at 5-10.
- 14 February 18, 2016 CFPB Press Release, available at <http://www.consumerfinance.gov/newsroom/cfpb-finalizes-policy-to-facilitate-consumer-friendly-innovation/>.
- 15 CFPB Innovation Policy at 24-29.
- 16 *Id.* at 29-33.
- 17 *Id.*

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## CONTACTS

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### New York

Jason J. Cabral	+1-212-558-7370	<a href="mailto:cabralj@sullcrom.com">cabralj@sullcrom.com</a>
Whitney A. Chatterjee	+1-212-558-4883	<a href="mailto:chatterjee@w@sullcrom.com">chatterjee@w@sullcrom.com</a>
H. Rodgin Cohen	+1-212-558-3534	<a href="mailto:cohenhr@sullcrom.com">cohenhr@sullcrom.com</a>
Elizabeth T. Davy	+1-212-558-7257	<a href="mailto:davye@sullcrom.com">davye@sullcrom.com</a>
Mitchell S. Eitel	+1-212-558-4960	<a href="mailto:eitelm@sullcrom.com">eitelm@sullcrom.com</a>
Michael T. Escue	+1-212-558-3721	<a href="mailto:escuem@sullcrom.com">escuem@sullcrom.com</a>
Jared M. Fishman	+1-212-558-1689	<a href="mailto:fishmanj@sullcrom.com">fishmanj@sullcrom.com</a>
C. Andrew Gerlach	+1-212-558-4789	<a href="mailto:gerlacha@sullcrom.com">gerlacha@sullcrom.com</a>
Andrew R. Gladin	+1-212-558-4080	<a href="mailto:gladina@sullcrom.com">gladina@sullcrom.com</a>
Wendy M. Goldberg	+1-212-558-7915	<a href="mailto:goldbergw@sullcrom.com">goldbergw@sullcrom.com</a>
Joseph A. Hearn	+1-212-558-4457	<a href="mailto:hearnj@sullcrom.com">hearnj@sullcrom.com</a>
Erik D. Lindauer	+1-212-558-3548	<a href="mailto:lindauere@sullcrom.com">lindauere@sullcrom.com</a>
Mark J. Menting	+1-212-558-4859	<a href="mailto:mentingm@sullcrom.com">mentingm@sullcrom.com</a>
Camille L. Orme	+1-212-558-3373	<a href="mailto:ormec@sullcrom.com">ormec@sullcrom.com</a>
Rebecca J. Simmons	+1-212-558-3175	<a href="mailto:simmons@r@sullcrom.com">simmons@r@sullcrom.com</a>
Donald J. Toumey	+1-212-558-4077	<a href="mailto:toumeyd@sullcrom.com">toumeyd@sullcrom.com</a>
Marc Trevino	+1-212-558-4239	<a href="mailto:trevinom@sullcrom.com">trevinom@sullcrom.com</a>
Mark J. Welshimer	+1-212-558-3669	<a href="mailto:welshimerm@sullcrom.com">welshimerm@sullcrom.com</a>
Michael M. Wiseman	+1-212-558-3846	<a href="mailto:wisemanm@sullcrom.com">wisemanm@sullcrom.com</a>

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# SULLIVAN & CROMWELL LLP

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## Washington, D.C.

Eric J. Kadel Jr.	+1-202-956-7640	<a href="mailto:kadelej@sullcrom.com">kadelej@sullcrom.com</a>
William F. Kroener III	+1-202-956-7095	<a href="mailto:kroenerw@sullcrom.com">kroenerw@sullcrom.com</a>
Stephen H. Meyer	+1-202-956-7605	<a href="mailto:meyerst@sullcrom.com">meyerst@sullcrom.com</a>
Jennifer L. Sutton	+1-202-956-7060	<a href="mailto:suttonj@sullcrom.com">suttonj@sullcrom.com</a>
Andrea R. Tokheim	+1-202-956-7015	<a href="mailto:tokheima@sullcrom.com">tokheima@sullcrom.com</a>
Samuel R. Woodall III	+1-202-956-7584	<a href="mailto:woodalls@sullcrom.com">woodalls@sullcrom.com</a>

---

## Los Angeles

Patrick S. Brown	+1-310-712-6603	<a href="mailto:brownp@sullcrom.com">brownp@sullcrom.com</a>
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## London

Mark J. Welshimer	+44-20-7959-8495	<a href="mailto:welshimerm@sullcrom.com">welshimerm@sullcrom.com</a>
George H. White III	+44-20-7959-8570	<a href="mailto:whiteg@sullcrom.com">whiteg@sullcrom.com</a>

---

## Paris

William D. Torchiana	+33-1-7304-5890	<a href="mailto:torchianaw@sullcrom.com">torchianaw@sullcrom.com</a>
----------------------	-----------------	--

---

## Melbourne

Robert Chu	+61-3-9635-1506	<a href="mailto:chur@sullcrom.com">chur@sullcrom.com</a>
Burr Henly	+61-3-9635-1508	<a href="mailto:henlyb@sullcrom.com">henlyb@sullcrom.com</a>

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## Tokyo

Keiji Hatano	+81-3-3213-6171	<a href="mailto:hatanok@sullcrom.com">hatanok@sullcrom.com</a>
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