American Bankers Association
Building Success. Together.

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By electronic submission to: Innovation@occ.treas.gov

Office of the Comptroller of the Currency
400 Seventh St., S.W.
Washington, D.C. 20219

Re: *Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective*

Ladies and Gentlemen:

The American Bankers Association (ABA)[1] welcomes the March 2016 Whitepaper of the Office of the Comptroller (OCC), "*Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective*"[2] (Whitepaper). The ABA strongly supports OCC in its proactive effort to facilitate banks' responsible innovation. The Whitepaper is a timely update and a reminder of the important role that innovation has always played and continues to play in successful banking. ABA is pleased to share with you some of our observations and comments on this important paper and the issues that it addresses. We view this as an ongoing discussion, and we are eager to participate in it.

In the financial services universe, innovation and technological change are closely related concepts, but the terms are not synonymous. The term "fintech"—often used to describe the convergence of technology and financial services—is now the moniker used for tech-focused startups. But innovation is much more than that: it is about leveraging technology and broader expertise to deliver banking products in more effective ways. The issue on which the Whitepaper correctly focuses is how banks do new things, whether with old, current, or new technology, to accomplish something very traditional: meeting constantly evolving customer needs for financial services. Banks, in order to be successful, have always faced, and met, this challenge.

Accordingly, we concur with the approach of the Whitepaper that responsible innovation has a much wider application beyond fintech. We believe that the successful principles for technology innovation are and should be part and parcel of traditional supervision. The Whitepaper provides an opportunity to review how supervision is facilitating innovation and where improvements can be made. We welcome the invitation from the OCC to provide the ideas of the banking industry in that regard.

There are many challenges, and indeed frustrations, that bankers face in their efforts to meet evolving needs and expectations of their customers. Bankers' sense of urgency to deploy new

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[1] The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend more than $8 trillion in loans.

[2] http://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-39.html

technology and continually innovate in other ways is real. It is driven by consumer preference and by the competition to meet those preferences. The OCC's efforts to educate itself by engaging with banks and nonbanks developing new ideas is a critical piece of the OCC's program to encourage responsible innovation. There is great value in understanding new technologies, products, and services, and the benefits and risks they present. Lessons learned here will find echo in the dialogue that field examiners will have with the banks.

It is important to keep ever in mind how this will contribute to the health of the financial system and the economy. This is the business of banking. By definition, banks are in the business of growth. Banks prosper only as their customers and communities prosper. Successful businesses and people who thrive repay loans and seek more financial services, making growth a bank's leading product.

From their creation, banks in the United States have been looked to by the customers they serve and the governments which have chartered them to develop certain core competencies, seen as key to the economic progress of the nation, its people, and their businesses. While some nonbank financial firms provide some of these services, no other industry offers them all, and none have been chartered by government to fulfill these important roles. Among these core bank competencies are the following (presented without ranking of priority):

- Financial Intermediation between Savers and Borrowers
- Maturity Transformation of Financial Instruments
- Custodial Services
- Trust Services
- Creation and Operation of the Payments System
- Capital Formation
- Liquidity Provision
- Cash Management
- Government Finance
- Wealth Management
- Currency and Coin Dissemination

It is noteworthy that the Whitepaper, drawing upon experience with federally-chartered banks, highlights some of the strengths that banks have developed in the course of building these competencies:

> Our diverse system of banks has many advantages in developing and adapting financial innovations. Federally chartered institutions have stable funding sources, capital, and extensive customer relationships. They also have a long history of risk management that has led to enhanced information security capabilities, mature credit modeling and underwriting processes, and compliance programs that help protect consumers. These capabilities lay a foundation for innovation in the 21st century, and are major reasons the federal banking system still serves as a source of strength for the nation after 153 years.

We believe that this applies with equal force to state-chartered institutions and that our dual banking system of federal and state chartering adds a measure of resilience not found in the banking structure of other nations.

When the national banking system was created, in the depths of the Civil War, it was an affirmative action by both the executive and legislative branches to endorse and promote the role of banking. That view was reiterated by the federal government a generation later with the creation of the Federal Reserve System and yet again with the creation of the Federal Deposit Insurance Corporation. At its core, and whatever the debate over its particulars, the Dodd-Frank Act reaffirmed the essential role of banking, the competencies that banks are expected continually to develop, and the responsibility that banks have in supporting and promoting economic growth and financial progress.

Banks have never been alone in this work. One key result of a successful regulatory framework will be effective partnerships between banks and nonbank firms. The more comfortable that banks—and their supervisors—are with banks partnering with nonbank firms, the better they can deliver these innovative solutions to their customers in a safe, sound, and responsible and timely manner. The OCC can play a significant role in facilitating partnerships by providing clarity and facilitating discussion about the nature of these relationships.

Essential to an effective regulatory framework will be enhanced collaboration among regulators. Collaboration is not synonymous with bureaucracy; it must be just the opposite. If done correctly, it will serve to spread knowledge quickly, minimize inconsistencies, avoid conflicting guidance, and speed adoption of valuable innovations. For example, pilot programs, which we think can be important elements in technology deployment in a safe and sound way, seem a natural area where collaboration among regulators will be important and speed adoption more broadly.

Recommendations for Further Consideration

In our comment we will also offer several recommendations for further consideration:

- **ABA Supports the OCC's Definition of Responsible Innovation**
  The OCC's receptivity to innovation as it has defined it holds promise for experimentation that will benefit our customers and our industry, providing room for refinements and improvements based upon the acid test of customer and market response.

- **Fostering a Culture of Innovation throughout the Agency**
  Innovation in providing customer services touches upon activities throughout the OCC. A welcoming environment for innovation cannot be confined to one office or division.

- **Supervisors' Facilitation of Innovation Should Rarely Require Special Procedures**
  Innovations should not become bogged down in a bureaucratic structure that requires permission, consultation, or notice requirements. What is needed is supervisory

openness to innovation, supported by knowledge and judgement that reaches to frontline supervisory staff.

- **OCC Could Provide a "Learning Center" to Facilitate Innovation**
  This kind of facility might be especially beneficial to community banks, who often will have smaller budgets for pilot programs and other testing that is critical to many innovative efforts.

- **OCC Could Facilitate a New Innovative Approach to Third-Party Vendor Relationships**
  A common source of frustration for community banks is that some vendors, including core processors, are not investing in research and development and are not allowing new technologies (such as mobile banking) to be incorporated into their systems.

- **OCC Can Encourage Innovation through Pilot Programs**
  Banks will be more successful if they can test their ideas, refine and adjust them according to demonstrated customer preferences, and identify and resolve other problems, including attention to unforeseen risk management concerns.

- **OCC Could Facilitate Partnerships of Banks and Nonbank Firms**
  Banks do not pretend to a monopoly of good ideas, but we have a demonstrated interest and ability to incorporate them. Partnerships provide opportunities to meet customer needs in an efficient and effective manner and should be encouraged and facilitated by the agency.

- **Modernization of Regulatory Concepts Would Foster Innovation**
  Regulatory standards and definitions that were developed decades ago can pose unnecessary obstacles. New innovative approaches may be needed to adapt these to the new economic realities while preserving the integrity of risk management and supervisory processes.

- **Innovation Flourishes, and More Customers Are Served When Markets Are Allowed to Function and Customers Are Allowed to Choose**
  Building upon a shared commitment, financial regulators and the banking industry can work together to identify movable obstacles to financial services access. This includes recognizing the need for economic viability, addressing regulatory restrictions, and allowing informed customers to make their own choices. More customers will be brought into the financial mainstream as a result.

- **The OCC Is Positioned to Inform Other Financial and Non-Financial Regulators**
  Coordination among the OCC, the Bureau, the FDIC, the Federal Reserve, and the Conference of State Bank Supervisors to promote a consistent approach for reviewing and providing feedback on innovative products and services is critical. Working with nonbank regulators is also important to assure that consistent oversight is provided and regulation is based on activities, not providers.

I. ABA Supports the OCC's Definition of Responsible Innovation

The OCC has defined responsible innovation as follows:

> 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.

ABA supports that definition, embodying the OCC's recognition of the broad scope innovation can take. Although some of the more headline-grabbing current innovation in financial services is taking the form of faster or more convenient delivery mechanisms leveraging electronic communication tools and infrastructure, innovation can also mean new ways to promote financial literacy, expanded access to financial services, tailored loan repayment programs for the growing number of self-employed customers, and savings programs that are tied to annual raises, among others. These can be new ways of looking at service provision, not heavily dependent on new technologies.

We agree on the foundation point that the needs of our customers should be the driver for our innovation efforts and customer reaction to them the measure of their success. Because those needs are similarly diverse as our customers, we also believe that the OCC has rightly defined responsible innovation so as to foster variety (a prerequisite for innovation), within the necessary context of consistency with sound risk management and banks' business strategies. The application of those two criteria ensure that a new product or service can be provided to serve customers in a sustainable, ongoing fashion. The OCC's receptivity to innovation as it has defined it holds promise for experimentation that will benefit our customers and our industry, providing room for refinements and improvements on new ideas as they face the acid test of customer acceptance.

II. The OCC Has Identified Guiding Principles that Are Appropriately Sympathetic to Responsible Innovation

The focus reflected in the OCC's guiding principles is welcome. Its approach to consider ways in which the agency can serve as a resource and, in appropriate ways, a facilitator could function as a model for other financial industry supervisors. A successful outcome of the OCC's innovation initiative would be a framework permitting the OCC to be flexible, well-informed, engaged, timely in its decisions and collaborative with industry.

The Whitepaper points to a number of specific, tangible efforts. We support the OCC's interest, for example, in streamlining some of its licensing procedures or developing new procedures especially as they may relate to the opportunity to test or pilot new products or services on a small scale.[3]

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[3] The OCC recently issued proposed guidance for comment that would permit banks to originate residential mortgage loans that exceed supervisory loan-to-value guidance under certain conditions. The OCC notes this program represents an innovative lending program. OCC, *Proposed Information Collection: Risk Management Guidance for Higher Loan-to-Value Lending in Communities Targeted for Revitalization*, 2016.

ABA welcomes similarly the OCC's exploration of ways that the agency can provide a clear path for banks and others to seek guidance, as well as how the OCC could expedite decision making when a decision or opinion may be required. In particular, we underscore the value of the OCC's intention to "Foster an internal culture receptive to responsible innovation." Painful experience teaches that delaying the ability of banks to employ innovative ideas or technologies not only delays customer access to innovation's benefits, it also hobbles the ability of banks to compete with nonbanks, surrendering market share and the value to the bank of its innovation.

We appreciate that the OCC recognizes that the many banks it supervises currently interact with the OCC in a variety of ways and for numerous purposes, any of which could touch upon issues and matters involved with innovation. We anticipate that this supportive internal culture at the OCC would reach throughout the agency.

In the same way that the OCC recognizes that innovation should feature in its mission, ABA agrees that responsible innovation has a place in the strategic planning of banks, indeed has been traditionally how banks have kept pace with the needs of their customers. We note that serendipitous or experimental innovation, properly scoped and piloted, can serve customers as well as banks.

The OCC notes that examiners are often the primary points of contact for banks considering innovations, and ABA commends the OCC's commitment to develop or augment existing training that would assist staff throughout the agency, especially examination staff, to support responsible innovation. ABA recognizes the OCC's initiative to develop lead experts in a number of areas of bank activity and agrees that similar expertise in product, service and operational innovation could be usefully developed as a resource for the agency, the banking industry, and nonbank innovators. ABA believes that the several suggestions that the OCC makes regarding outreach to bank and nonbank innovators would enhance the OCC's role as a resource. Many ABA members are receptive to the OCC's willingness to share success stories about innovations—not limited to those that reflect progress in expanding access to financial services.

ABA recognizes that the OCC is not the primary supervisory agency for all banks, and that even for its charter holders other supervisory agencies may have a role. In this regard, ABA commends the OCC's willingness and plan to work with other agencies, such as the Bureau of Consumer Financial Protection (Bureau), to facilitate a consistent approach to supervising responsible innovation.

We would offer an additional point that rises to the importance of being included as a "Governing Principle." Innovation must incorporate necessary and appropriate security protections, extending to treatment of data, privacy concerns, and cyber threats. Based upon the many statements by OCC officials on these points, we believe that this principle is well understood by the OCC; we merely emphasize the value in restating and listing it prominently.

III. Receptivity to Responsible Innovation Throughout the Agency Would Best Serve the Industry and the Public

We acknowledge and appreciate the favorable sentiment that the Whitepaper expresses toward innovation in general. Of course, it is in the details where banks live and they are the substance of what supervisors review. Whether or not the OCC chooses to modify its own organization as part of this initiative, it is critical to successful promotion of responsible innovation that agency personnel dealing with banks on the front lines of supervision be both open to banks' innovation and sufficiently technically sophisticated to evaluate new products and services — or know where and how to tap into such knowledge within the agency. Though traditional risk management knowledge and discipline, e.g., credit risk management, service provider/counterparty evaluation, etc., will play critical roles, from time to time new knowledge about information security, customer communication methods, and other technical knowledge will be important for supervisory personnel, just as they are for bank management. New products or services that bank management may wish to introduce will receive appropriate attention from bank examiners, and successful responsible innovation will be encouraged or impeded, depending upon the degree to which those supervisors acknowledge the value of innovation to the bank's ongoing health.

1. *Examination Teams Play a Critical Role*

While no examiner requires expertise in every technical risk management discipline, successful promotion of responsible innovation does require, however, an acknowledgement by every supervisor that it is an important and traditional part of running a banking business. It follows that facilitating responsible innovation by the banks they supervise must be an integral part of each supervisor's standard of successful personal performance. That is not to say that it is the responsibility of supervisory staff to press for or direct bank management in innovative strategies, but examiners should be accepting of this part of a bank's strategic evolution, rather than simply viewing innovation as a source of increased potential risk. As part of the assessment of their individual performance, supervisory personnel's judgment in evaluating risks and benefits of innovation should receive considerable weight. There is simply no alternative to making responsible innovation a material part of frontline supervisors' professional success, just as evolution of a bank's products and services and how they are delivered are key to how customers evaluate the institutions with which they bank.

The implementation described above is especially critical for community banks' success in responsible innovation. Community banks' dialogue with supervisors is overwhelmingly conducted through their local examination teams. An appropriately open attitude from the examiner in charge can be as encouraging to responsible innovation at community banks as skepticism can become a hard obstacle to surmount.

2. *Banks Can Assess Whether Permission, Consultation, or Notice Is Required*

Supervisors' facilitation of innovation should rarely require special procedures. Developing and bringing to market new or improved financial products, services, and processes is an integral part of a typical bank's business model. Since the ultimate value of innovation is its potential to improve service to customers, banks are driven to explore a variety of avenues within the range of their resources, legal authorities, and strategic plans, consistent with sound risk management, to continue to preserve, refine, and build their competencies on which their customers rely.

Continuous innovation has been an important aspect of successful banks' strategies, and therefore it will be part of each bank's dialogue with its supervisors. The ongoing communication that must occur between bank management and examiners concerning the bank's overall strategic direction and general risk management is an appropriate way for supervisors to gain insight into each bank's innovative business strategies, activities, and products. Most successful innovations will not call for a specialized supervisor function or process. When specialized technical knowledge is relevant to the prudent implementation of new bank products and activities, having additional expertise available from agency subject-matter experts from time to time will be valuable. What is needed in every case, however, is a supervisory openness to innovation, supported by the attitude, sufficient level of knowledge, and judgement of frontline supervisory staff.

IV. The Appropriate Role for the OCC as a Significant Resource

ABA agrees that the OCC staff has varied and deep expertise regarding the banking system, and that its expertise can be leveraged to enhance its, and the industry's, understanding of responsible innovation. We see the following important objectives that the OCC could seek to fulfill: developing internal expertise; offering consultation for banks, nonbanks, and vendors to banks; conducting outreach; and facilitating prompt and effective agency decision-making.

We observe the following cautions regarding the concept of a centralized office on innovation: the potential of 'siloing' the idea of innovation within the agency; the perception of additional levels of decision-makers; and the risk of detaching decision making from the field. We offer below our ideas for the OCC to consider.

1. *The OCC Could Provide a "Learning Center" to Facilitate Innovation*

Though most critical innovation activities will occur in the field, the OCC could possibly assist by maintaining a central resource that would allow it and banks (especially community banks) to watch trends and benefit from experiences of other institutions. Even with appropriate respect for other banks' intellectual property, the OCC staff will necessarily become aware of experiences in the industry that could allow other banks to avoid repetitious trial and error. This kind of facility might be especially beneficial to community banks, who often will have smaller budgets for pilot programs and other testing that is critical to many innovative efforts. Similarly, as community banks cannot afford to hire employees expert in specific technologies simply for new product or service testing, a facility that permits shared expertise could facilitate pilot programs at community banks. The OCC has previously encouraged a similar kind of shared expertise and collaboration for community banks across a range of activities.[4]

Such a facility could provide a common informational ground for banks of all sizes, as well as nonbank businesses interested in working with the banking industry.[5] A "learning center" could perhaps serve to enhance banks' use of innovative third-party technology resources and vendor management. Industry members large and small report that potential partners and service providers frequently lack understanding about the regulations to which banks are subject and the

[4] OCC Whitepaper, NR 2015-1, *An Opportunity for Community Banks: Working together Collaboratively*, January 2015.

[5] It is appropriate for the OCC to consider its function and role in assessing its priorities in fostering innovation. In this regard, we note that the OCC is funded by bank assessments and has a statutory mandate respecting national banks and federally-chartered savings associations suggesting priorities along the following lines: banks and de novo banks; banks in formation; vendors and third party service providers in operation, offering financial products and services, and operating in-partnership with banks.

regulatory environment in which they operate. Many vendors provide services to industries other than banking and, in many cases, are unfamiliar with the regulatory and supervisory structure applicable to banks. Successful vendor management means much more than risk management, and this is an ongoing challenge when dealing with well-established tech firms as well as start-up companies. For this reason, we recommend consideration of a learning center that would provide a centralized location for banks, prospective vendors and partners, and existing service providers to obtain information about bank regulation and supervisory expectations regarding third-party relationships. There are a variety of ways in which the OCC could develop and share its expertise:

- Develop expertise. Engage with existing expertise within the Executive Branch (e.g. Presidential Information fellows, technology and cyber experts at DHS, FBI, Secret Service and others) and engage with expert staff at bank and non-bank innovation labs.

- Self-Service Channels. Provide online educational materials to service providers explaining bank regulation, supervision, and what the OCC expects from service providers.

- Convene Core Processor Dialogue. Convene meetings or forums among core processors, the OCC, and banks to understand better the services rendered and processes involved to deliver innovative technology -- including 'plug and play' application program interfaces -- with the goal of evolving the technical efficacy of core processors and the community banks reliant on them.

- Vendor Boot Camp. Host or co-sponsor a symposium that educates service providers about the compliance and supervisory environment within which banks operate.

- Regulatory Trends. Proactively share with banks and service providers "regulatory hot spots," examination trends (including trends identified in vendor exams), and lessons learned from third-party relationships. This could take the form of a regular, consolidated report that discusses relevant issues learned from the OCC's examination of critical service providers. This could be a joint, FFIEC project that is similar to the Bureau's quarterly Supervisory Highlights publication.

- Concomitantly, we would suggest for consideration the formation of an Innovation Advisory Council of representatives from OCC-supervised institutions to give direct feedback to the OCC on trends, concerns, and regulatory roadblocks.

In addition to proactively sharing information and expertise about third-party management, ABA recommends that the OCC update its guidance on third-party risk management and new product development. Prior to issuing revised guidance, the OCC should seek input from banks and service providers to promote transparency and to ensure that the guidance provides the direction most relevant and needed. Below are preliminary recommendations for issues that such guidance could address. Updates could address third-party management with respect to innovation initiatives as well as third-party management more generally.

- Due Diligence. We request that the OCC explain a bank's options for conducting due diligence on a service provider's regulatory compliance prior to contracting with that vendor. Community and mid-size banks commonly express frustration regarding their inability to obtain examination information before contracting with a critical service provider (particularly one for which the OCC has already identified significant problems). Banks prefer to learn about compliance problems before entering a business relationship, and they find it challenging to conduct due diligence in this regard.

  As the OCC is aware, legal restrictions prohibit banks from accessing or sharing the details of a vendor's examination report prior to entering into a contractual relationship with that vendor. Furthermore, anti-trust laws limit the dialogue that banks are able to have through their trade association on this topic. As a result, we request that the OCC (1) clarify permissible and impermissible information sharing in this context, and (2) share examples of acceptable compliance due diligence practices or "alternative due diligence" in which a bank could engage before contracting with a vendor.

- Examinations. It would be valuable if updated guidance explained how clients of a particular service provider may obtain a copy of the exam report. Our members report some variation in whether banks must formally request the report from the regulator or whether they receive the reports automatically. Other banks have reported that they had to request specifically to be placed on a distribution list containing the exam information.

- New Companies. Updated guidance could address acceptable approaches for managing the risk of partnering with new, upcoming companies that do not have a lengthy financial history or that have negative financial statements.

2. Think Innovatively With Respect to Third-Party Relationships

In addition to the intention expressed in the Whitepaper of removing certain barriers to innovation generally, we urge the OCC to think creatively about how it approaches and communicates information about third-party relationships.

- Vendor Responsiveness to Innovation. A common source of frustration of community banks is that some vendors, including core processors, are not investing in research and development and are not allowing new technologies (such as mobile banking) to be incorporated into their systems. It is important that vendors keep up with technological changes that allow community banks to integrate modern products and services in order to compete effectively in the marketplace. The OCC could consider incorporating into its service provider examinations a review of how the provider plans for and responds to innovation and changes in technology.

- Supervisory Information. As discussed above, banks are limited in their ability to evaluate a service provider's compliance with applicable laws and regulations prior to entering a contractual relationship. The OCC, on the other hand, has significant information and expertise regarding service provider compliance. We urge the OCC to think creatively about what information it could provide to assist banks in this regard. For example, one option would be for the OCC to share a topical list of MRAs that have been issued to a particular service provider so long as a bank has formally extended a request for proposal and is subject to a confidentiality agreement. We urge the OCC to consider alternatives to the status quo, and to consider recommendations for legislative or regulatory changes that might be required.

- Fintech Already Scrutinized. The OCC would promote awareness and ease diligence by community banks by publicizing 'fintech' partnerships—those that support operations as well as consumer facing applications—that have already received regulatory scrutiny.

- Foster development of standards and interoperability. Banks indicate, for example, growing interest in distributed ledger technology. Business applications of this innovation are at an experimental stage. The OCC could consider ways to foster the development of standards and encourage interoperability.

- Timeliness. Banks report that after regulators conclude a vendor examination, it commonly takes 6 – 9 months for a bank to obtain a copy of the examination report. This is problematic, particularly for institutions who are in the process of renewing or renegotiating their vendor contracts. We urge the OCC, in consultation with other regulators, to consider how to provide more timely information to service provider clients.

3. *Facilitate Agency Decision Making*

The OCC notes that it learned through its discussions to date on its innovation initiative that there is a common perception that innovators must undertake a deliberate and extended vetting process that can inadvertently discourage innovation. Rather than establish another decision maker in the agency—like a centralized innovation office—the OCC could consider empowering an existing office, such as the ombudsman office, to facilitate required agency decisions that are not progressing.

V. The OCC Can Encourage Innovation Through Pilot Programs

Innovations are rarely successful unless real-world testing and refinement play a role in the development process, market reception being the most demanding test. Banks will be more successful if they can test their ideas, refine and adjust them according to demonstrated customer preferences, and identify and resolve other problems, including attention to unforeseen compliance issues and risk management concerns. This can often be done more nimbly and satisfactorily before a full-scale program is deployed. We would recommend that supervisors be enabled to encourage this aspect of product and service development. This would both facilitate adoption of new technological solutions (by permitting testing prior to full-scale commitment) and enhance risk management (by permitting discovery and learning prior to larger-scale commitment).

We make this recommendation in light of language in the Whitepaper recognizing that it is appropriate to take some risk in furtherance of promoting banks' competitiveness in meeting customer needs. This recommendation is also offered in light of the OCC's recently expressed willingness to exercise "discretion in the areas of supervision, policy and licensing decisions, enforcement actions, regulation development and interpretation, interagency coordination and banking powers."[6] We discuss below ongoing efforts of banks to test and incorporate technology innovations and some potential for such testing in the residential mortgage market.

1. *Banks Continually Leverage Technology to Serve Customers*

Banks invest tens of billions of dollars annually in technology, much of which is devoted to new financial information tools and applications. Security of customer information tops the list of investments, followed by data analytics, payment services and new mobile and online banking applications. Some individual banks have developed their own dedicated staff groups focusing on innovation. These "innovation laboratories" provide opportunities for bank staff and management to think more broadly about the next steps in improving customer service and meeting competition. Innovation can thus align more closely to strategic planning rather than being aimed at solving current problems. In many cases these dedicated staffs have close working relationships with the banks' key outside technology vendors and other service providers, allowing for ongoing knowledge transfers and acclimatization of vendors. Many of these banks have also made significant efforts to familiarize their examination teams with this part of their approach to innovation, beginning the process of integrating innovation with the examination process, as well as with strategic planning.

Banks also partner with technology companies to employ new innovations. These partnerships provide products and services to bank customers from small business lending to streamlined online loan applications to peer-to-peer payments through 'texts.'

2. *Mortgage Lending Pilot Programs*

The regulatory environment for mortgage lending has become highly complex. The legal uncertainty—added to the complicated application of these new laws and regulations to everyday facts—discourages banks from improving mortgage origination processes or products. To facilitate innovation, the OCC could partner with other regulatory agencies to encourage banks to try new ideas in a "safe zone" that provides adequate transparency for regulators while limiting regulatory risks, protecting consumers, and appropriately integrating the parties that have roles in the new product or process being developed. Such pilot programs could address:

- Mortgage Disclosures. Mortgage disclosure requirements under TILA and RESPA are complex, and there is significant uncertainty in the market regarding the liability that any compliance exceptions place on mortgage lenders and investors. These ambiguities have discouraged innovation and illustrate how pilot programs could be an important testing ground for new ideas and delivery channels that might otherwise go untapped due to legal and regulatory uncertainty. Pilot programs could also be used to address modernization of font and similar disclosure requirements that are not currently workable on smartphones and other digital devices.

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[6] OCC, Risk Appetite Statement, April 2016

- RESPA. Section 8 of RESPA restricts fee splitting and referral payments. It is unclear, however, how these restrictions apply with respect to online mortgage transactions, including the compensation of online shopping websites that aggregate product information from multiple financial service providers (i.e., "aggregator" sites). Within that ambiguity, it is difficult to develop various online mortgage services. A pilot where that ambiguity is addressed in a controlled way could foster development of products and services of value to borrowers.

Existing mortgage-related laws and regulations provide the Bureau with broad authority to provide banks the flexibility to create and test innovative products and processes. To ensure that regulation does not choke innovation, Congress provided the Bureau with broad "exemptive" powers under RESPA, TILA, and Title X of the Dodd-Frank Act. These provisions are consistent with the concept of a small-scale, short-term experiment to determine how the product or process would work if provided on a larger scale. Both regulators and banks would benefit from the ability to test and adjust products and processes. We encourage the OCC to coordinate with the Bureau to encourage banks to develop more effective and efficient products and processes that can be tested in this manner.

While the Bureau is charged with implementing consumer protection rules, the ability of banks to develop and test new products and processes is central to banks' ability to compete with other financial service providers and remain relevant in the marketplace, thereby expanding the competition from which customers benefit. Inasmuch as many banks—particularly community banks—are examined by prudential regulators and not by the Bureau, efforts to facilitate innovation in the mortgage business must be conducted with full cooperation across all relevant regulatory agencies. Below are some examples of existing laws and regulations that allow the Bureau to oversee the development of new initiatives without stifling innovative ideas.

- Section 19 of RESPA provides the Bureau the authority to "grant such reasonable exemptions for classes of transactions" necessary to achieve the purposes of RESPA.

- Sections 105(a) and (f) of TILA provide the Bureau the authority to exempt classes of products from the requirements of TILA.

- Section 1405 of Dodd-Frank allows the Bureau to exempt from or modify disclosure requirements for any class of residential mortgage loan if such exemption or modification is in the interest of consumers and is in the public interest.

- Section 1032(e) of Dodd-Frank provides the Bureau with authority to permit trial programs intended to improve upon existing consumer disclosure requirements. Regulated entities conducting a trial disclosure program will be deemed to be in compliance with, or may be exempted from, a requirement of a rule or an enumerated consumer law.

Unlike other transactions that involve only creditor-consumer interaction, mortgage lending involves numerous participants that contribute to the transaction and that interface directly with the customer. In addition, compliance lapses at these third parties can result in legal and regulatory liability for the bank. As a result, mortgage lending innovation must be coordinated among lenders, borrowers, real estate agents, appraisers, loan processors, underwriters, closing agents, mortgage loan investors, and other ancillary service providers. To advance any significant innovation, all stakeholders must be able to access and share data through similar technologies and web-hosted platforms. Due to the involvement of these parties in a mortgage transaction, pilot programs could be particularly helpful in testing a new initiative or a new process prior to applying it more broadly, demonstrating to a variety of regulators the feasibility of the effort.

VI. Modernization of Regulatory Concepts Would Foster Innovation

The Whitepaper recognizes the technological changes in financial services, from mobile wallets to distributed ledger technology to automated lending decisions and raising equity capital through crowdfunding. While responsible innovation would preserve the integrity of risk management and supervisory processes, there is a concomitant need for language and concepts to be adapted to the business environment in which banks serve their customers. In particular, we would note that customer communication and interaction channels have evolved greatly in the recent past, with the rise of mobile and online customer interfaces for many businesses. Customers and potential customers, particularly of the millennial generation, have become accustomed to these highly convenient and increasingly sophisticated means of shopping, handling personal budgets, and accomplishing their daily routines in a secure, convenient manner. Banks are focused on succeeding in mastering and leading these channels, both to deliver effective customer service and to succeed in developing and expanding their markets. Yet, regulatory standards and definitions that were developed decades ago can pose unnecessary obstacles, often poorly adapted to innovative services and products, providing little in the nature of prudential supervisory benefit or customer protection. Addressing those can be a win for customers and their financial services providers.

1. Bank Presence in Communities

A vexing problem in the Community Reinvestment Act (CRA) context has been the definition of an assessment area. The current definition was adopted when the CRA rules were revised in 1995. While the definition might have had some relevance 20 years ago, new service delivery mechanisms through changing technology have made that definition outdated. The current approach is wedded to a physical presence.

For example, it was not unusual 20 years ago for college students to set up bank accounts where they were going to school, but now it can be simpler to maintain a banking relationship with a parent's bank even though it may be hundreds of miles away. Similarly, members of the armed forces no longer have to change banks when they change duty stations, and they can maintain an account relationship with the bank where they originally opened an account, even though that bank may be on the other side of the continent.

The point is that physical presence is not the only appropriate defining element for an assessment area, and the definition should be adapted (within statutory limits) to new technologies. At the same time, though, it is critically important to allow the bank to define an assessment area based on the market that it can logically serve, and it should not reflect a very small presence due to a single loan customer based far away from the bank. ABA commends the OCC's interest in promoting awareness of innovative activities that could qualify for CRA consideration and urges the OCC to work with the other regulatory agencies to allow greater flexibility in granting credit for activities outside a bank's defined assessment area; the current approach discourages such activity.[7]

More generally, banks use a variety of new approaches to reach customers and potential customers, in addition to traditional branch networks. ABA would bring before the OCC for its consideration innovative alternatives that support the desire to provide a presence in the community through new kinds of branches. Banks are currently experimenting with mobile branches that can move from place-to-place, facilities that consist of ITMs and kiosks with minimal personnel, 'hub-and-spoke' branches with a full service branch as an anchor to several smaller 'express' branches. In this regard, the OCC could update its guidance on what is considered a branch to permit flexibility in moving in and out of markets through non-brick and mortar facilities like interactive teller machines (ITMs). We believe that through these and other innovations bankers may actually be able to do more to benefit a community if they are not constrained by the traditional bricks-and-mortar presence, and we look forward to engaging with the OCC in consideration of such possibilities.

Another significant concern inherent in analyzing new technologies and innovative practices under the constraints of CRA performance is the lack of demographic information that would permit a clear demonstration that products or services are used by low- and moderate-income customers. When a bank tries new ideas for reaching customers, such as opening a retail office in a store frequented by a significant percentage of low- and moderate-income shoppers, those activities may not be counted for CRA purposes. In theory, a CRA examiner is supposed to consider the performance context and make a judgment call that would grant favorable CRA consideration to these and similar activities, but that is not the case in practice. In order to encourage application of new technologies to promote financial participation, more flexibility in making demographic assessments would be useful as well as a clear statement by regulatory authorities that such a technology or other innovative business approach is eligible for CRA credit.

2. *Serving Deposit Customers*

Banks use a wide variety of channels to communicate to customers information about deposit products and also to serve customers who have placed deposits with them. In doing so, banks employ a variety of intermediaries in accordance with customer choices. In the process of serving customers in these ways, banks can face regulatory issues from the outdated and overly broad definition of "brokered deposit," applied in ways that could capture and complicate arrangements and customer access channels far removed from the risks that brokered-deposit restrictions were originally designed to control. In many if not most cases, these issues arise when banks use customer communications technology that did not exist when the regulations were written and valuable customer choices were similarly unavailable. The need is not for regulatory laxity, but for updating standards that have clearly been rendered obsolete by

[7] Comptroller Curry indicated in a March 2016 speech that the federal banking agencies are currently working on updating their Q&As on CRA. We look forward to progress in modernizing the agencies' approach, which we have long urged. (See, http://www.aba.com/Advocacy/commentletters/Documents/cl-CRA-QA2014Nov.pdf.)

innovation and retail customer preferences. We believe that with appropriate regulatory adjustment the prudential supervision purposes can be achieved without inhibiting customer service.

Similarly, we believe that adjustments can be made to the regulations distinguishing among different account types for monetary control purposes to render them consistent with how customers' account usage has evolved. Current restrictions on withdrawals and transfers from money market deposit accounts (MMDAs) both inhibit meeting customers' needs and prohibit banks from matching, let alone exceeding, the offerings of nonbank competitors. We know that this was not the intent of bank regulators, since their original objective in permitting banks to offer MMDAs was to allow banks to meet customer needs in competitive ways. Not infrequently, bank customers can become frustrated, and the bank may fail in its goal of increasing customer access to the banking system because of lack of a truly competitive product. We welcome the invitation in the Whitepaper to work with regulators to address problems such as these.

VII. Innovation Flourishes When Markets Are Allowed to Function and Customers Are Allowed to Choose

ABA shares the OCC's commitment to encourage innovative approaches to expand access to the banking system. Building upon that shared commitment, financial regulators and the banking industry can work together to identify movable obstacles to financial services access. The banking industry believes that much can be achieved by means of fostering an environment in which the industry is allowed to innovate in offering products and services to an expanding portion of the population, both in traditional ways and through methods previously unknown but now brought within reach by new technologies and approaches. We offer three key themes in fostering such an environment.

1. *Recognize Need for Economic Sustainability*

Key to offering and maintaining any product—particularly products designed to facilitate access to the banking system—is sustainability. Simply put, in order for a product or service to be successful and sustainable, the product or service must generate revenues, and those revenues must exceed costs.

Small-dollar loans and low balance bank accounts pose particular challenges with regard to sustainability, in view of very narrow margins between revenues and costs. Innovation can be particularly important here as the means for reducing costs of providing these financial services. Banks have been trying a number of different approaches to meet the needs of these customers, with promising response from customers, but more than occasionally with some resistance from regulators who have looked at the new products in old ways. We suggest that meeting these low-margin markets and expanding access to financial services may require a regulatory view of revenues that matches their function. For example, applying an annual percentage rate to small-dollar loans that have durations measured in weeks or months is misleading, is not the way that customers look at these products and their prices, and does not represent the way that banks tend to price these services. A fee-based approach for these services could make real prices much clearer to customers while also facilitating the ability of providers to cover costs and allowing the addition of appealing features so that these banking services are sustainable, clearly priced, and attractive to a wider range of customers.

2. *Address Regulatory Restrictions and Provide Regulatory Clarity*

We offer some examples of recent and even current regulatory issues where a focus on access to financial services could lead to better results in terms of delivering more financial services to more customers, and in the process bringing more customers into the financial mainstream. In each of these cases, we stress the value of innovative ideas (whether or not employing new technologies) joined together with the new regulatory approach to innovation expressed in the Whitepaper.

- Direct Deposit Advance Products. Past guidance on deposit advance products imposed significant and impractical requirements for offering small-dollar loans linked to a deposit account and sent the message that offering small-dollar loans is risky from a supervisory perspective. Banks backed away from these products. We hope that the door can be opened to a reconsideration of how these types of arrangements can be made to work on a sustainable basis.

- The Military Lending Act Regulations. The recent revisions to the Military Lending Act implementing regulations present significant interpretation and application issues, which if resolved well can make the difference between expanding or contracting access to financial services. Banks share the Defense Department's preference for the former. Prudential regulators can lend their expertise to facilitate those clarifications and application of the new regulations in the most positive ways for military families. Areas for much needed and immediate work include oral disclosure requirements, verification of military status, and overall reductions in complexity for customers and lenders.

- Unfair, Deceptive, or Abusive Acts and Practices (UDAAP). The vague and subjective laws against unfair, deceptive, or abusive acts and practices can serve as powerful deterrents to innovation. Financial services innovators by definition will be offering products and services that are new in important ways and without a history of regulatory review. Prescreening innovations through regulators can significantly retard developing and marketing of new ideas. Banks, when contemplating offering innovative services to marginalized populations, are more likely to attract supervisory scrutiny. Clarity of standards can help, as well as expedited regulatory guidance when needed, but the persistent threat of an undefined UDAAP sanction hovers like a dark cloud over financial innovation. There is something of a case history to clarify the meaning of "unfair" or "deceptive," but there is nothing to rely on to guide innovators with regard to what is meant by "abusive," particularly how it might apply where the innovation does not otherwise stray onto ground considered "unfair" or "deceptive." Further inhibition of investment in such products relates to the retrospective nature of unfair, deceptive, and abusive charges and the unpredictability and negative publicity of enforcement actions. We believe that clarification of the application of UDAAP would do much to remove a major inhibition to innovation within the banking industry. It is hard for financial firms to focus on expanding access when doing so may also invite expanded (and hitherto undefined) legal vulnerability.

- Rulemaking through enforcement. The problems with UDAAP are compounded where there are policies intended to establish regulatory standards not by public rulemaking but rather through enforcement actions and consent decrees. Enforcement actions are always governed by facts specific to the parties involved, and lack the clarity and public exposure of regulations refined by public input. Innovators are left unsure as to whether an innovation popular with customers might nevertheless at some later date run afoul of an unwritten regulatory standard.

The OCC's discussion in the Whitepaper that it is seeking a "clear path for banks…to seek the agency's views and guidance" and its acknowledgement that "to be effective, the improved process should clarify agency expectations" is a positive note that offers the potential to counter many, though not all, of the challenges described above. We look forward to further dialog to build upon this important approach, particularly for the benefit of bringing more customers into the financial mainstream.

3. Allow Informed Customers to Make Their Own Choices

What the Whitepaper treats, and what we discuss in our response, is innovation connected with providing products and services to customers. Innovations, therefore, focused on customers should give significant deference to customer choices and preferences. Rather than override customer preferences, efforts would better focus on ensuring that consumers understand a product. Ultimately, customers determine whether a product is valuable, and they are the most rigorous of regulators.

VIII. The OCC Is Positioned to Inform Other Financial and Non-Financial Regulators

We support the expressed view of the Whitepaper that the OCC can play an important role collaborating with other banking agencies to "promote a common understanding and consistent application of laws, regulations, and guidance" in order to "support responsible innovation in the financial services industry." The OCC could work more closely not only with the other banking agencies, but also with nonbank agencies whose actions can affect innovation by banks. Because of the wide dispersal of supervisory responsibility for bank operations, OCC leadership in the wider supervisory community on matters related to innovation will be valuable. Besides the influence of prudential regulators concerned with bank safety and soundness on the pace and direction of innovation, "conduct regulators" (such as the Securities and Exchange Commission and the Bureau) also significantly affect innovation.[8] A vigorous, forward-leaning program that remains contained within a single agency will be limited in its benefits for either the public or the banking industry.

[8] A public example of the OCC's beneficial effort to educate another regulator is the May 24, 2011, letter sent by Acting Comptroller Walsh to the SEC regarding the SEC's proposal to require municipal advisors to register with the SEC.

1. *Need for Consistent Supervisory Approach Among Bank Regulators*

We urge the OCC to coordinate with the Bureau, the FDIC, the Federal Reserve, and the Conference of State Bank Supervisors to promote a consistent approach for reviewing and providing feedback on innovative products and services. Consistency will be important in situations where regulatory approval is required as well as in circumstances where financial institutions are seeking general regulatory feedback and clarification. Exchanging information with other regulators and coordinating regulatory responses to innovative products would be particularly important in the context of pilot programs and trial products. In some cases, regulations and practices do not allow banks to employ widely-used technologies that exist today. While the OCC does not issue many of the rules governing consumer disclosures or other consumer protection requirements, we note that the prudential regulators evaluate regulations promulgated by the Bureau before they are finalized, pursuant to consultation requirements of the Dodd-Frank Act.

2. *Nonbank Regulators Would Benefit*

Many initiatives are undertaken by non-bank agencies that directly or indirectly impact banks and their ability to innovate. The OCC's broad and deep understanding of the industry, informed by its innovation framework, could be usefully deployed so that these initiatives do not unnecessarily constrain innovation. We offer two examples to illustrate the point.

a. *TCPA*

   Greater collaboration is needed between the OCC and the Federal Communications Commission (FCC) to ensure that banks can efficiently and effectively serve their customers and comply with their regulatory obligations. New technologies have dramatically improved the opportunity for banks to provide necessary and valuable communications to their customers. Fraud alerts, notices of address discrepancies, data security breach notifications, delinquency notifications, loan modification outreach, and other time-critical, *non-telemarketing* communications can be of enormous value to large numbers of customers, and current technology offers the promise to reach them promptly and at reasonable cost. The Telephone Consumer Protection Act (TCPA), however, prohibits most telephone calls to landlines and mobile phones using an automatic telephone dialing system (autodialer) unless the caller has the prior express consent of the called party. This statute—which was enacted in 1991 at a time when cell phones were not widely owned and calls were expensive—has been interpreted by the FCC in ways that unnecessarily impede banks' efforts to communicate with their customers about critical matters. The OCC could play a significant role in helping the FCC to recognize the benefits to financial customers of receiving these important, non-telemarketing calls.

b. *E-Signatures*

   Various governmental entities play an important role in mortgage finance and related processes, yet they do not offer fully automated solutions or platforms that support basic technological advances. For instance, the U.S. Department of Housing and Urban Development (HUD) has only recently issued guidance to accept e-signatures for mortgage originations, but not all documents may qualify. HUD desk reviews and examinations still mandate submissions of paper files and documents. As a result, investors and aggregators often require that originators submit paper documents, and banks and consumers are often unable to make use of the E-Sign Act and associated technologies that are widely available. Again, the OCC could help HUD recognize the value of what is now a common technology, useful to customers.

<u>Conclusion</u>

The Whitepaper (and therefore our comments on it) is forward looking, speaking to the principles of progress and growth, the innovation that will support progressive bank services, and the challenges and obstacles to innovation and product transformation to support current and future customer needs and interests. The banking industry has consistently met these obligations and challenges through innovation developed in-house, in partnership with innovators outside of the banking industry, and through adoption of good ideas from whatever source. We have also been made better by competition. Always, our customers have reaped the benefits. We hope and expect that tradition to continue.

We reiterate that ABA welcomes the OCC Whitepaper and believes that the ideas and concepts presented are an important and sensible approach toward innovation and the role that it has always played and will continue to play in successful banking. We welcome the emphasis that it places on the involvement of the OCC in facilitating the ability of banks to continue to innovate to meet customer needs. As banks find better ways to serve their customers the banks can, of course, also benefit from greater ease and regulatory certainty in introducing new products and services. Also important, the OCC has the opportunity to set the tone and direction for the numerous agencies that supervise financial institutions. As noted in this letter, successful innovation will call for both a common willingness and significant cooperation among regulators.

The Whitepaper is the latest—and a valuable—exchange in the ongoing dialog between regulator and industry on how banks can evolve, adapt, and change their products and services to keep pace with ever changing customer needs. With a focus on what works for bank customers, we look forward to continuing that essential dialog.

Sincerely,

Wayne A. Abernathy
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