

OCC Releases Whitepaper on “Responsible Innovation”

April 1, 2016

Financial Institutions

Yesterday, the Office of the Comptroller of the Currency (“OCC”) issued a whitepaper, [*Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective*](#), that introduces the agency’s principles for facilitating and regulating “responsible innovation” in the federal banking system, particularly in financial technology or “fintech.” The whitepaper primarily contemplates reforms to the manner in which the *agency* evaluates new product proposals from banks, as well as banks’ involvement with new technology providers. It does not address some of the critical structural limitations imposed on banks, such as activity restrictions, and it does not broach the broader question of whether new types of regulation ought to apply to new technological methods for delivering financial services, whether or not delivered by banks. Nevertheless, the whitepaper signals the beginning of a longer and broader undertaking by the OCC, banks, other financial regulators, and other market participants to develop a framework for approaching financial innovation.

The agency has requested comments on all aspects of the whitepaper, including specific questions listed below, by May 31, 2016. Concurrently with releasing the whitepaper, the OCC announced that it intends to host a forum on responsible innovation on June 23, 2016.

The OCC’s Innovation Initiative

The whitepaper provides background information on the OCC Innovation Initiative announced in August 2015. As part of the initiative’s findings, the whitepaper recognizes that innovation, including mobile payments services, blockchain technologies, mobile wallets, online marketplace lending, automated financial advisory services, and algorithmic underwriting, presents banks with opportunities to gain access to new markets and customers. At the same time, the agency views innovation as presenting unique risks to customers, banks, and the financial system.¹ Accordingly, the OCC’s whitepaper seeks to nurture what the agency describes as “responsible innovation.”

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

¹ As one example of the caution with which innovation is viewed, Comptroller of the Currency Thomas J. Curry, in remarks announcing the whitepaper, made the following statement regarding certain new lenders: “I would worry about the staying power of some of the new types of lenders. One of the great virtues of community banks is that they know their customers and they stand behind them in good times and bad. I’m not so sure that customers selected by an algorithm would fare as well in a downturn.”

bank's overall business strategy." This definition is notably broad, and can be interpreted to include fintech as well as other innovations.² In addition, as emphasized in the Comptroller's remarks announcing the whitepaper, the whitepaper calls for innovation to be consistent with consumer protections and "consumer rights."

Eight Guiding Principles for Responsible Innovation

The OCC's whitepaper identifies eight principles to guide the agency in developing a framework for understanding and evaluating innovative products, services, and processes that OCC-supervised banks may offer:

1. **Support responsible innovation.** The whitepaper recognizes that the agency's processes for evaluating innovation and communicating with firms considering new products and services can be inconsistent and inefficient. To address this concern, the OCC is considering:
 - establishing a centralized office on innovation to serve as a forum to vet ideas, to seek the agency's views and guidance, and to support the agency's other functions;
 - issuing additional guidance on new product development and third-party risk management;
 - streamlining or developing new licensing procedures for innovative activities; and
 - allowing banks to test or pilot new products and services on a small scale before committing significant bank resources to a full rollout, though the agency made clear that it would not offer banks a safe harbor from consumer laws and regulations during the testing phase.
2. **Foster an internal culture receptive to responsible innovation.** The whitepaper recognizes that the OCC is sometimes perceived in the industry as having low risk tolerance for innovative products and services, and can discourage innovation by taking too long to evaluate new products and services. The OCC plans to focus on training and communication within the agency to adopt a more open-minded approach to innovation.
3. **Leverage agency experience and expertise.** Encouraging responsible innovation will involve a coordinated, multi-disciplinary approach from the OCC's examination, compliance, community reinvestment, payments, economics, and technology teams, among others. The OCC will consider designating lead experts on responsible innovation who can support bank supervision and provide advice based on a broad view of innovation trends within the banking system.
4. **Encourage responsible innovation that provides fair access to financial services and fair treatment of consumers.** The OCC recognizes that technology provides banks an effective platform to offer services to unbanked and underserved consumers, including young adults, low- and moderate-income consumers, and minorities. The OCC also intends to encourage the use of non-technological innovations such as social

² For example, the OCC notes that the recent financial crisis was "fueled in part by innovations such as optional adjustable rate mortgages, structures investment vehicles, and a variety of complex securities," even though the focus of the whitepaper appears to be on fintech, a seemingly different category of innovations.

responsibility funds, small business investment funds, mortgage-backed securities backed by Community Reinvestment Act-qualified investments, and tax credit programs for these consumers.

5. **Further safe and sound operations through effective risk management.** The OCC expects banks to meet supervisory expectations described in existing OCC guidance relating to strategic planning, evaluation of new products and services, use of models, operational risk, data privacy risk, cybersecurity, and management of third-party relationships.
6. **Encourage banks of all sizes to integrate responsible innovation into their strategic planning.** The OCC encourages banks to adopt innovations as part of their long-term business plans, strategic objectives, and overall risk appetites, “rather than following the latest fad or industry trend,” as long as such innovation is consistent with “traditional strategic planning criteria.”
7. **Promote ongoing dialogue through formal outreach.** The OCC intends to communicate with banks, technology companies, and consumer groups – including through “innovator fairs” – to stay abreast of trends, understand opportunities and risks, and discuss supervisory expectations.
8. **Collaborate with other regulators.** The OCC will work with other financial regulators, including the Consumer Financial Protection Bureau and other bank regulatory agencies, to exchange ideas, minimize inconsistencies, and share information.

The OCC’s Principles Cautiously Open the Door to Innovation

The OCC’s whitepaper is significant because it publicly recognizes the supervisory and regulatory obstacles that banks and fintech companies currently confront when innovating. At the same time, the whitepaper includes few concrete steps that the OCC will take to foster innovation, instead providing high-level principles that will guide these steps in the future.

The whitepaper does not, for instance, address the sometimes significant legal and supervisory barriers that banks face to innovation. Banking organizations’ investments in fintech companies remain subject to the activity restrictions and other requirements of the National Bank Act, the Home Owners’ Loan Act, the Federal Deposit Insurance Act, and the Bank Holding Company Act of 1956, as amended. In addition, fintech companies that provide services to banking organizations are potentially subject to examination under the Bank Service Company Act. The whitepaper also does not address the relevance of banks’ “assessment areas” for purposes of Community Reinvestment Act performance evaluations as online and mobile banking use increases. In addition, the whitepaper does not discuss the chartering of fintech companies, although the Comptroller’s remarks released in conjunction with the whitepaper touch on this subject. Finally, the whitepaper does not attempt to address the larger question of whether new types of regulation ought to apply to new technological methods for delivering financial services, whether or not delivered by banks.

Nevertheless, the whitepaper clearly represents a spark for further discussions on the issues surrounding bank innovation, and signals a new focus by the OCC on addressing the issues in a way that balances the industry’s commercial interests, consumer interests, and safety and soundness considerations.

Comments Requested on the Whitepaper

The OCC has requested public comments on all aspects of its whitepaper, including on the following specific questions:

- What challenges do community banks face with regard to emerging technology and financial innovation?
- How can the OCC facilitate responsible innovation by institutions of all sizes?
- How can the OCC enhance its process for monitoring and assessing innovation within the federal banking system?
- How would establishing a centralized office of innovation within the OCC facilitate more open, timely, and ongoing dialogue regarding opportunities for responsible innovation?
- How could the OCC provide guidance to nonbank innovators regarding its expectations for banks' interactions and partnerships with such companies?
- What additional tools and resources would help community bankers incorporate innovation into their strategic planning processes?
- What additional guidance could support responsible innovation? How could the OCC revise existing guidance to promote responsible innovation?
- What forms of outreach and information sharing venues are the most effective?
- What should the OCC consider with respect to innovation?

Comments are required to be submitted to the OCC by May 31, 2016, and represent a real opportunity for stakeholders to influence the agency's thinking on this broad new topic.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Financial Institutions Group and Consumer Financial Services Practice:

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