Via email to: thirdpartylending@fdic.gov

Rae-Ann Miller
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550 17th Street, N. W.
Washington, DC 20429-9990

**RE: FDIC Seeking Comment on Proposed Guidance for Third-Party Lending FIL 50-2016**

Dear Ms. Miller,

Thank you for the opportunity to comment on the Proposed Guidance for Third-Party Lending FIL 50-2016 (the "Proposed Guidance"). I appreciate the FDIC's openness and willingness to accept public comment and recommendations to improve the final version of any potential guidance or regulations.

In crafting this comment letter I used the assumption that all guidance and regulation issued by the FDIC is intended by the FDIC to be aligned with its mission as stated:

> ***Mission***
>
> *The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by the Congress to maintain stability and public confidence in the nation's financial system by:*
> - *insuring deposits;*
> - *examining and supervising financial institutions for safety and soundness and consumer protection;*
> - *making large and complex financial institutions resolvable; and*
> - *managing receiverships*

I'm using the additional assumption that the objective of any new guidance or regulation issued by the FDIC for third-party lending or financial technology (fintech) is to prevent:

1) the likelihood of failure of an insured financial institution (protect the viability of the deposit insurance fund)
2) material harm to consumers

I also assume that the FDIC is supportive of financial innovation offered in a safe and sound manner that:

1) Increases efficiency or lowers costs for consumers or insured financial institutions ("FIs") (e.g. online banking)
2) Provides a new benefit or convenience to consumers (e.g. mobile deposit)
3) Expands the availability of credit to creditworthy borrowers and/or reduces the risk of default for borrowers and risk of losses to FIs (e.g. artificial intelligence or modeling that allows FI lending that is less risky than traditional credit models and metrics might estimate)

When I use the terms 'financial innovation' or 'innovation' in this comment letter I am referring to true value added innovation that either reduces the cost to the FI or consumer or delivers a unique new or enhanced value to the FI or consumer. I am specifically not referring to 'complex financial engineering' used to create a product or service with the primary intent of separating consumers from their hard earned money more efficiently for the sole purpose of increasing a company's revenue and earnings.

My Background and Context for Comments

My background includes experience in each of the aspects of the proposed guidance; audit and examination, management and risk management for a FI, and fintech innovation. Hopefully my unique background and insights from the perspective of each of the interested parties' roles will be beneficial in helping the FDIC craft a final version of the guidance that provides for the desirable outcome of prudent risk management and consumer protection, while avoiding unnecessarily stifling or burdening of FIs and financial innovation to the ultimate detriment of consumers.

While my comments are founded in my background and current position as the Founder, CEO and President of a Texas community bank that has active and successful fintech and third-party lending partnerships, I will attempt to avoid comments or suggestions grounded in self-interest for myself or my FI in the interest of crafting simpler, more effective regulation and guidance for the industry as a whole which is beneficial to accomplishing the stated goals of the FDIC in this area without creating an undue and overly complex regulatory schema.

My background includes:

Audit and Assurance of FIs

I have served in the role of an auditor of FIs for one of the 'Big Six' audit firms in the United States. While not identical to the role of Bank Examiner, as an auditor my activities included many of the same or similar functions of an examiner in examining and rendering judgment on the financial stability, internal controls, policy, processes and procedures, loan portfolio quality, risk management and management practices, etc. of FIs.

Fintech Start-Up (Third-party Lending and Payment Vendor)

I have served in the roles of product development, FI partnership development, management, and marketing for a fintech startup. In those roles I assisted in developing a successful ASP based commercial credit and payment platform that was later acquired by one of the nation's largest FIs.

De Novo Community Bank

I have served in the roles of founder and director of a community bank launched in 2006, and two years later in 2008 I assumed the roles of President and CEO of the bank.

Fintech Partner Community Bank

The bank I manage has formed third-party fintech/lending relationships during my tenure as President and CEO and I have hopefully gleaned valuable experience from both our success and failures that I can contribute to the FDIC in crafting better guidance and regulation.

Approach

I took the content of FIL 44-2008 and FIL 50-2016 and aligned each section with the corresponding section of the other FIL. I then analyzed each provision in the guidance to draft my comments.

Objective

The stated objective of the Proposed Guidance is: "The FDIC is seeking comment on proposed Guidance for Third-Party Lending to set forth safety and soundness and consumer compliance measures FDIC-supervised institutions should follow when lending through a business relationship with a third party."

Based on the stated objective, I assume the genesis of this proposed guidance is to address regulatory uncertainty in the area of emerging fintech lenders' partnerships with FIs and FIs' use of new technology or platforms for lending provided by third-party vendors.

Comments:
The FDIC requested comments to a set of questions. I will comment on the questions and then provide general personal comments.

For ease of reading, FDIC questions and guidance are highlighted in grey. *My comments are in blue italic font.*

Third-Party Lending Definition and Scope of Guidance

1. The Proposed Guidance defines third-party lending as "a lending arrangement that relies on a third party to perform a significant aspect of the lending process." Does the proposed definition appropriately capture the various types of financial institution lending through relationships with third parties?

2. Is the scope of the definition (and therefore, the scope of the guidance) appropriate, too broad, or too narrow?

3. The proposed third-party lending definition also describes examples of services performed by a third party. Do those services appropriately reflect services being provided, and may be reasonably expected to be provided in the future, by third parties?

***The Proposed Guidance appears to be so broadly defined as to include the current activities of virtually every FI.***

*I am not aware of a single FI that would not have lending activity that would fall under the definition and scope in the Proposed Guidance. Most insured depository institutions do not develop lending technology in-house. Most FIs use third-party software or services to perform significant aspects of the lending function.*

*For example:*

*Marketing and Borrower Solicitation*
*Many FIs use a third-party website provider, marketing/advertising agency, various advertising channels and medium, etc. for marketing lending products. Many FIs use third-party platforms or software for accepting loan applications online or soliciting borrowers online.*

*Credit Underwriting*
*Many (most?) FIs use third-party underwriting software for generating DTI/DSCR ratio analysis and evaluating the financial position of a potential borrower/credit applicant.*

*Loan Origination*
*Many insured FIs use third-party software for generating loan documents (e.g. LaserPro), online document delivery (e.g. ZixSecure), or borrower execution of loan documents (e.g. Docusign).*

*Consumer Disclosures and Regulatory Compliance*
*With the ever growing complexity of consumer protection regulation, I believe most FIs have abandoned developing proprietary consumer disclosure documents in-house and use third-party generated documents. Additionally, the burden of consumer compliance has become so great and untenable that many (most?) small community banks have outsourced large parts of the consumer compliance function to third-parties. For example, here in Texas use of the Compliance Alliance service offered by the Texas Bankers Association.*

*Loan Servicing and Debt Collection*
*With the increased servicing requirements for residential consumer lending, in particular escrow requirements, many community banks have outsourced loan servicing and debt collection for consumer mortgage loans to third-party servicers.*

*Data Collection, Aggregation, or Reporting.*
*Any bank that uses a core provider and didn't develop its own core platform in-house is using a third-party for lending data collection, aggregation, and reporting.*

*Given the list of examples above, most of these third-party lending arrangements would be considered significant, because almost all of them* "have a material impact on revenues, expenses, or capital; involve large lending volumes in relation to the bank's balance sheet; involve multiple third parties; or present material risk of consumer harm".

*I don't believe it is the FDIC's intent to just reiterate the third-party guidance in FIL 44-2008 for all these well-established existing uses of lending software or services by FIs, therefore I would recommend the FDIC reevaluate the scope of the guidance to be more specific about its objective for the Proposed Guidance vs. the 'catch-all' definition currently in the Proposed Guidance.*

4. The Proposed Guidance outlines three categories of third-party lending arrangements: originating loans for third parties; originating loans through third parties or jointly with third parties; and originating loans using platforms developed by third parties. Do those examples appropriately capture the various types of arrangements? Are the respective descriptions of those arrangements appropriate?

*I would suggest that the FDIC consider using the third-party arrangements described in this section in the definition for the scope of the Proposed Guidance.*

1) Insured institutions originating loans for third parties
*This definition is clear and concise.*

2) Insured institutions originating loans through third-party lenders or jointly with third-party lenders
*I believe this definition is attempting to describe traditional indirect lending models (perhaps just automated?). Perhaps clarifying this definition or adding an example would be beneficial for the reader.*

3) Insured institutions originating loans using platforms developed by third parties
*In my honest opinion, **<u>this IS the future of banking</u>**. It should not be viewed as a 'bad thing' by the FDIC <u>or as an exception requiring enhanced supervision</u>. It should be the expectation that all FIs will be moving in this direction.*

*Banks that continue to use MS Word, MS Excel, and disjointed credit origination processes and software requiring multiple points of manual entry and that have labor intensive lending processes and non-integrated loan document and consumer disclosure generation will fall by the wayside as inefficient and more error prone with slower service and response times and poorer credit quality which will all trend the FI towards unprofitability leading to sale or closure of the FI in the long run.*

5. The Proposed Guidance notes the numerous risks that may arise from use of third parties and outlines those that may be associated with third-party lending programs in particular. While recognizing that not all risks can be outlined, does the Proposed Guidance reasonably identify and describe the risks that warrant emphasis for third-party lending arrangements? If not, which additional risks should be addressed?

*The cliff notes version of the risk identification and responsibility from FIL 44-2008 and the Proposed Guidance is that FI Management and Directors are held accountable for all risks and undesirable outcomes/failures of any product or service, regardless of who is responsible for the root cause.*

*While the risks identified in FIL 44-2008 and the Proposed Guidance present a somewhat exhaustive list of potential risks, they do not include the two largest risks faced by community banks today.*

1) *The Risk of Doing Nothing (maintaining the status quo)*
2) *Regulatory Risk*

*<u>Risk of Doing Nothing/Status Quo Risk</u>*
***The single largest risk to the long-term viability of community bank lending is the <u>Risk of Doing Nothing</u>.*** *Community bank's that do not innovate their lending practices, which almost certainly includes using third-party vendors, will likely underperform or cease to exist. Community banks have long relied on 'relationship' as a differentiating factor when most other aspects of their service delivery were on par with competition. Relying solely on 'relationship' as a differentiating competitive factor when other aspects of customer service or risk management are not on par with competition is a severe risk to the continued existence of a FI.*

*The FDIC may want to consider including in general guidance, requesting FIs to analyze the risk of maintaining the status quo and doing nothing. This is the exact opposite of the current proposed approach. Instead of asking the question 'why are you implementing a new third-party lending relationship or platform' and all the associated risks,* *asking 'why are you not implementing a new third-party lending relationship or platform?' and what are the risks of not taking action.*

*Example*
*Traditionally community banks have acquired loans through personal community networking to generate a pipeline of generic loan leads typically grouped by loan type. Credit decisions are based on obtaining a borrower's tax returns, personal financial statement, and credit report in addition to information on the business or property that is the subject of the credit request. The process of collecting and analyzing this information can take days to weeks with the generation of loan documents, disclosures, and loan closing taking additional time. This information is by definition stale the day the credit is originated, as tax returns may be based on information that is 16 to 22 months stale and the personal financial statement starts aging the day after it is compiled and provided to the FI. Loan pricing is typically generic with potential ranges for approved loans with generally similar characteristics. Monitoring of a credit may be monthly in a best case scenario, but more likely quarterly or annually.*

*Now contrast this with the potential competition. Loans are acquired online via very specifically designed marketing programs that create a pipeline of applicants that meet tightly defined borrower criteria. Borrower information can be 'instantly' acquired via APIs through financial or other data aggregators such as Plaid, Quickbooks, UPS, MLS, or FedEx. Borrower information is automatically analyzed to generate a recommended (or automatic) credit decision and credit memo template, loan documents, disclosures, and closing package all of which can be delivered and executed online. Not only is the financial information current, cash flow, debt service, and LTV/LTC along with a myriad of other important borrower/collateral attributes and trends can be updated and automatically analyzed daily, allowing lending staff to be proactive rather than reactive to potential credit deterioration. Loans can be granularly priced based on specific and measureable risk, providing the best possible pricing to the best possible borrowers, all while removing loan officer personal bias that may create the unintended potential for fair lending violations.*

*The potential long-term result is better borrowers get a faster loan decision and origination with less hassle and potentially better pricing from the competition. FIs using new technology and processes end up being more efficient, with lower risk credits monitored in real-time, and can use employee expertise to focus on the 'does this loan make sense' question and evaluating borrower character, vs mundane data entry and financial analysis of stale information. FIs using old antiquated manual processes and stale data for loan analysis and monitoring will end up potentially being adversely selected by less creditworthy borrowers in the long-run.*

*Regulatory Risk*
*Another significant risk omitted from FIL 44-2008 and the Proposed Guidance is **Regulatory Risk**. Regulatory Risk is the risk that overly-complex and ever expanding regulation and guidance maybe over-zealously applied to community banks, stifling their ability to innovate, operate, or compete with non-bank financial entities and large-mega banks. This is a very real risk for most community banks today. The proposed guidance alone references over 20 other pieces of guidance and regulation, all of which undoubtedly reference hundreds of pages of additional regulation. The latest regulatory guidance from the CFPB for consumer mortgage lending includes 293 pages (TRID revised guidance) and 901 page guidance on mortgage servicing rules. The CFPB final rule for prepaid cards is 1,689 pages. It's simply not possible for community banks to review and comply with rules this expansive in nature with staffs of 10, 20, or 30 employees.*

*It took me dozens of hours to decompose the Proposed Guidance and referenced guidance to prepare this comment letter. I only have 11 other employees in my institution. The 'spider-web' of regulation is creating analysis paralysis for community banks where the regulatory requirements to do anything other than the status quo is daunting and overwhelming, if not outright impossible, and as outlined above, the status quo is the path to extinction for community banks.*

*Risk of Failure of a Third-Party Vendor.*
*A third more tactical risk that is somewhat covered in the existing guidance is the potential for a third-party lending partner to cease operations. Risks that should be examined include how the FI will either continue to offer the product or service in the absence of the vendor (transfer to another service provider or bring in-house), or a plan to wind it down (i.e. is it a transactional relationship that can just be 'turned off' or is it an ongoing function that must be wound down over time).*

6. The Proposed Guidance outlines expectations for establishing a third-party lending risk management program, including expectations around strategic planning policy development, risk assessment, due diligence and ongoing oversight, model risk management, vendor oversight, and contract structuring and review. Are these the appropriate elements for an adequate risk management framework?

*Yes, if applied to a narrower definition of third-party lending activity as described earlier.*

*The contract structuring and review guidance provided in FIL 44-2008 is excellent. The additional contract structuring and review guidance provided in the Proposed Guidance is beneficial, but it should not include a requirement for the FI to obtain a formal legal opinion* "Legal counsel review should include …an opinion concerning any potential recourse to the institution." *The FI should of course evaluate potential recourse to the FI, but should not be required to obtain an independent legal opinion on the matter.*

7. The Proposed Guidance outlines some of the risk management areas examiners will consider when reviewing third-party lending relationships. These considerations include credit underwriting and administration, loss recognition practices, the applicability of subprime lending guidance, capital adequacy, liquidity and funding, profitability and budgeting, accounting and allowance for loan and lease losses maintenance, consumer compliance, programs for safeguarding customer information, and information technology. Are the considerations appropriate? Should additional considerations be addressed?

*Yes, I believe the considerations listed are appropriate with two suggestions of items to consider:*

*<u>Underwriting</u>*
*My FI does not originate conventional consumer mortgage loans for direct or eventual sale to FNMA/FHLMC (we stopped all consumer mortgage origination several years ago due to the untenable burden of consumer compliance for an institution our size), but I believe this provision in the proposed guidance is in direct conflict with how the conventional mortgage market actually works:* "Whether an institution is originating loans for a third party, through/jointly with a third party, or using platforms developed by a third party, credit underwriting and administration standards must be established by the institution, not the third party." *It is my understanding that FIs often use platforms developed and offered by FNMA/FHLMC to underwrite and originate conventional consumer mortgage loans and the FIs underwrite those loans according to underwriting standards established by FNMA/FHLMC as their requirements to purchase the closed loans from the FIs.*

*<u>Subprime</u>*
*While the removal of the 25% capital exposure constraint appears appropriate for high-volume programs, perhaps the FDIC might consider revisiting the subprime guidance and expanded subprime guidance in the near future. While the definition of 'subprime' in the guidance is appropriate* ("extending credit to borrowers who exhibit characteristics indicating a significantly higher risk of default than traditional bank lending customers") *the guidance is over 15 years old and several of the 'subprime borrower credit characteristics' might benefit from updating, revision, or clarification.*

> *For example:*
>
> FICO score of 660 or below. *What FICO score? I am aware of 49 different available FICO scores.*
>
> DTI of 50% or greater. *Clarification of DTI. I assume this is 'gross income DTI' (as is typically used in mortgage origination) but it may be more accurate and a better practice and indicator of credit risk to use 'net income DTI' with a higher percentage threshold. A practical current example of this would be using an aforementioned third-party API to obtain actual consumer payroll deposits in real-time that would indicate net-pay or the true net free cash flow available for living expenses and debt service vs. gross pay.*

*What if technology allows for credit models and loan programs where credit is extended to individuals or entities with one or more of the characteristics listed as indicative of subprime lending in the guidance or expanded guidance, but which result in a lower risk of default than traditional bank lending customers? For example by including real-time accounts receivable, accounts payable, and shipping information for a commercial customer via an API, would that program still be classified as subprime simply because it includes extensions of credit to customers with characteristics indicative of subprime lending as defined 15+ years ago?*

*While it may be a more conservative approach to blanket classify programs as subprime at the discretion of the FDIC, is it appropriate if data driven mitigating information can be provided that illustrate 'bank like' performance for* *a loan program even though it allows for borrowers to have characteristics indicative of subprime lending as defined in the dated guidance?*

9. The Proposed Guidance indicates that institutions engaging in significant activity will generally receive increased supervisory attention. In this regard, the Proposed Guidance establishes a 12-month examination cycle for institutions with significant third-party lending programs, including for those institutions that may otherwise qualify for an 18-month examination cycle. Is this an appropriate examination interval for these types of arrangements?

***No.***

*The suggested frequency of examination cycle appears punitive and not aligned with the FDIC's risk based approach to bank examination for Risk Management and Consumer Compliance.*

*On what basis is this approach to examination suggested and supported as appropriate? Why require a full-scope concurrent Risk Management and Consumer Compliance examination on a more frequent examination cycle just because a community bank offers a new lending product or service or uses a third-party lending platform?*

*The proposed frequency of examination is only appropriate if the FDIC's objective is to discourage use of third-party lending vendors or partners and stifle financial innovation at community banks.*

> *1) The proposed approach to examination appears to be in direct conflict with the FDIC's 'risked based' examination approach. Subjecting a FI to full-scope annual and concurrent Risk Management and Consumer Compliance examinations would place the FI in an almost never-ending cycle of examination, a strong deterrent to any community bank contemplating implementing any new lending services facilitated by a third-party.*
>
> *2) Is the FDIC suggesting that it will unilaterally determine the examination cycle and timing for all state-chartered non-member banks?*
>
> *3) Has the FDIC consulted with the Conference of State Bank Supervisors for input on this proposed examination cycle? It would dramatically increase the personnel and resources required from every state supervisory agency to implement the proposed examination cycle.*
>
> *4) The Proposed Guidance states that every exam going forward would include an IT examination. In the current alternating lead agency examination model used in Texas for state chartered non-member banks, exams led by state agencies do not include an IT examination component. Is the FDIC proposing to be the lead agency on all future Risk Management examinations?*
>
> *5) Currently satisfactory rated banks are eligible for a 36 month consumer compliance examination cycle. Moving a satisfactory community bank to a 12 month examination cycle for merely using a third-party (as so broadly defined in the Proposed Guidance) to facilitate lending appears punitive and an attempt to discourage such innovation.*
>
> *6) What cost/benefit analysis was done to suggest that a full scope Risk Management examination conducted concurrently with a full-scope Consumer Compliance examination is warranted and would be beneficial in managing the risk of a new lending program or platform? Is this just overkill CYA? Is doing an annual review of C&D and CRE loans, sensitivity, IRR, etc. really appropriate or beneficial when all a FI has done is implement a lending platform?*

*I would like to suggest that the FDIC take an examination approach consistent with its risk based examination methodology. If a Bank has implemented a new program or platform the FDIC could simply request information on that initiative. There is no reason for the Bank, the FDIC, and the State agencies to all endure the burden, expense, and use of scare resources to have a more frequent full scope consumer compliance and risk management examination cycle, when a review of a specific initiative would identify new risk(s) and those findings could easily be incorporated into the existing or regularly scheduled examination cycle and report of examination findings and recommendations.*

10. The Proposed Guidance states that examiners will conduct targeted examinations of significant third party lending arrangements and may also conduct targeted examinations of other third parties, where authorized. As part of these reviews, the Proposed Guidance states that reviews of third parties should include transaction testing of

individual loans to assess compliance with consumer compliance regulations, underwriting and loan administration guidelines, credit quality, appropriate treatment of loans under delinquency, and re-aging and cure programs. Is the proposed scope of third party lending arrangement reviews and transaction testing appropriate?

*This is a tricky issue and a somewhat slippery slope. Due to the interconnectedness of emerging lending technology and the existing third-party lending ecosphere, the Proposed Guidance could lead to the FDIC being the de facto regulatory/examiner for all FI third-party lending vendors at the FDIC's sole discretion. Is that the intent of the Proposed Guidance?*

*It's my understanding that the FDIC already has the existing authority to examine 'affiliates' of FIs and that 'affiliate' is a defined term in regulation. Is the intent of the Proposed Guidance to expand the FDIC's examination purview to third-parties when the FDIC deems the third-party has a 'significant' or 'material' relationship with an FI even though the third-party may not meet the regulatory definition of 'affiliate'? Is there the potential for 'regulatory scope creep'? Is the FDIC proposing to examine a FIs' vendors' vendors' vendors? What if the vendor of a vendor of a FI is performing one of the functions listed above?*

*Is the FDIC proposing to subject entities such as FNMA and FHLMC to FDIC examination? As written, the Proposed Guidance includes FDIC examination of these entities. E.g. a small FI with a consumer mortgage origination operation may use a FNMA/FHLMC technology platform to originate, price, and sell many times its balance sheet in loan volume to FNMA/FHLMC and would meet the definition of a 'significant' third-party lending relationship as defined in the Proposed Guidance.*

*Is the FDIC proposing to examine all third-party loan servicers used by FIs? Third-party servicers perform many of the functions listed above for FIs and would also meet the definitions as written in the Proposed Guidance.*

**Personal Editorial Comments**

The following comments are my own general observations and thoughts related to the nature of the issues the FDIC is attempting to address with the Proposed Guidance.

The Challenge of Organizational Culture and Employee Personality Traits

The task of drafting guidance or regulation for emerging fintech or technology enabled third-party lending relationships is a challenging one for the FDIC or any regulator for that matter. This challenge is compounded by the chasm in institutional culture and employee personality traits between regulatory agencies and innovative financial services companies, with innovative community banks trapped somewhere in between.

Regulatory agencies judge and measure success primarily as avoiding failure. I'm not aware of any incentive for regulatory agencies or employees of those agencies to take any risk to create efficiencies or deliver any new value or a better experience to consumers or FIs. This culture is however completely understandable given the mission of the FDIC and that no congressperson or consumer advocacy group is waiting in the wings to say "Hey FDIC, you did a great job providing a workable regulatory framework for development of that new consumer product! You allowed for the successful development of a new financial product innovation that saved millions of people thousands of dollars and hundreds of hours.", but they are most certainly waiting in the wings to criticize the Board of the FDIC and its employees and management should something go wrong that causes a bank failure or harm to consumers.

Innovative fintech companies measure success by taking risks, often failing, and then overcoming those failures to ultimately achieve success (or fail and cease to exist). With a fintech company failure is an expectation, with a regulatory agency failure is a critical fault.

Not only are the two entity cultures fundamentally opposite, but the personality traits of employees within each entity are likely complete opposites. I don't believe anyone goes into a career as a regulator because they are a risk taker/seeker. Employees of regulatory agencies are likely risk averse, enjoy structure, and seek long-term stability. Employees of innovative fintech companies are risk takers, enjoy an unstructured environment and wide variety in their work, and are OK with a high degree of instability and uncertainty.

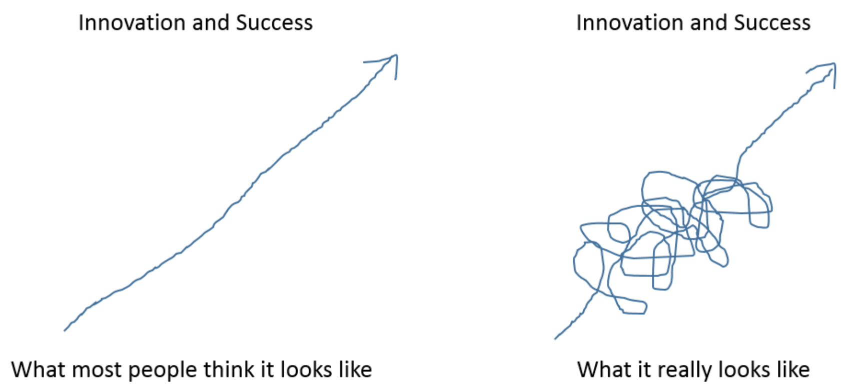
It is the difficult role of the innovative community bank to bridge the gap between the two. Helping the fintech company understand the importance of working within a regulatory framework with policy, procedure, and process for risk management and consumer protection while helping the FDIC understand the importance of rapid iteration, failure, and creative thinking in the attempt to create a new benefit or efficiency for the community bank or its customers. It's a fine line to walk, especially when the Management and Directors of the community bank are held accountable for all risks and undesirable outcomes/failures of any product or service, regardless of who is responsible for the root cause.

Risk Management (of Material Risks)

**It is an impossible task to identify, measure, monitor, and control every possible conceivable risk when innovating.**

I would suggest that regulators not strictly adhere to the precise letter and detail of guidance, but rather concentrate on the core of their Mission, and focus on real risks for the failure of an institution or for material consumer harm. Requiring an exhaustive risk analysis of every possible conceivable risk and a plan to measure, monitor, and control every conceivable risk might actually be detrimental to the FI and the FDIC's Mission by creating a distraction from focusing on the 'real' or most material risks of a new partnership, platform, or initiative.

Innovation is Uncertain, Messy and Difficult
Innovation is not a straight forward process. It is by definition filled with failure and uncertainty. Failure is part of the process of innovating and eventually succeeding. I've included what I feel is one of the best graphical representations of innovation and success below. (I'm not sure of the source so I can't credit it here).




It is said Thomas Edison failed over 1,000 times in attempting to create the light bulb. Depending on the source referenced, his response when asked about all his failures was to reply "I didn't fail 1,000 times. The light bulb was an invention with 1,000 steps" or that "he found 1,000 ways that did not work before he found one that did".

The point of both of these examples is that the FDIC should not focus on exhaustive risk management (which has steeply diminishing returns), 100% complete compliance with every word of guidance, or judge (incremental) failure as a 'bad' outcome.

For innovation and third-party relationships (lending or otherwise) the FDIC should not attempt to identify and regulate away all risk and failure, it is an impossible task that would kill innovation and risk taking. Rather I would suggest the FDIC would be better served by evaluating its guidance, examination approach, and enforcement related to financial innovation against the simple benchmark of its own core mission. The FDIC could ask two simple questions that are consistent with the mission of the FDIC as the core of its regulatory and examination approach:

1) Does this activity put the safety and soundness of the FI at risk resulting in a high probability of failure?
2) Is this activity causing material harm to consumers?

Level Playing Field
While many of the components identified in the Proposed Guidance (and reiterated from FIL 44-2008) are appropriate, the FDIC should not regulate away through exhaustive guidance or regulatory requirements the ability of smaller community banks to compete by offering innovative products and services. In crafting this guidance, or any additional guidance for that matter, the FDIC should focus on the two questions above and not on if the community bank sufficiently 'papered up' a file with enough documentation to meet the requirements of the Proposed Guidance to the letter.

FDIC Taking the Initiative
Recently legislation was proposed by Patrick McHenry (R-N.C.). The legislation, H.R.6118 - Financial Services Innovation Act of 2016, would provide for a 'sandbox' for innovation for FIs and fintech vendors overseen by a Financial Services Innovation Office within a regulatory agency. This seems like a common sense approach to the conundrum of regulating rapidly evolving 'responsible' financial service innovation faced by the agencies today. But why wait for legislation to potentially make it a requirement? Why not take the proactive step of establishing a Financial Services Innovation Office of your own volition? It might take some time to implement such a function as staffing for the office might likely need to come from outside of the agency to find individuals familiar with the innovation process (who have actually gone through it successfully) and that also have a healthy respect for the importance of regulation and consumer protection.

Format/Content Comment
In issuing any final guidance, I would respectfully request that the FDIC remove the large amount of redundant text currently present in the Proposed Guidance. Many of the provisions in the Proposed Guidance simply reiterate or

reword guidance found in FIL 44-2008 with some minor edit to include lending. This guidance will be read by thousands of people and the additional time required to compare the similar provisions between each set of guidance will result in tens of thousands of hours of wasted time. Please just reference the existing guidance from FIL 44-2008 at the beginning of the Proposed Guidance and then describe the new provisions or expanded parts of existing provisions.

Examples:

> Strategic Risk
> 44-2008: Strategic risk is the risk arising from adverse business decisions, or the failure to implement appropriate business decisions in a manner that is consistent with the institution's strategic goals. The use of a third party to perform banking functions or to offer products or services that do not help the financial institution achieve corporate strategic goals and provide an adequate return on investment exposes the financial institution to strategic risk.
>
> 50-2016: Strategic risk is the risk arising from adverse business decisions, or the failure to implement appropriate business decisions in a manner that is consistent with the institution's strategic goals. As a core banking function, the use of third parties to perform functions related to lending or to offer products or services that do not help the institution achieve corporate strategic goals exposes the institution to strategic risk. For instance, the potential misalignment of incentives or goals between the institution and the third party partner may elevate strategic risk.

> Operational risk.
> 44-2008: Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. Third-party relationships often integrate the internal processes of other organizations with the bank's processes and can increase the overall operational complexity.
>
> 50-2016: Operational risk is the loss resulting from inadequate or failed internal processes, people, and systems or from external events. Third-party lending relationships integrate the internal processes of other organizations with the bank's processes and can increase the overall operational complexity. Due to the nature of many third-party lending relationships, key operational factors such as underwriting, servicing, or other customer interaction may be completed at another location and/or by employees not under the direct supervision of the insured institution.

Sincerely,

Erik Beguin
CEO and President
Austin Capital Bank

CC:
Caroline Jones: Commissioner of the Texas Department of Savings and Mortgage Lending
Charles Cooper: Texas Banking Commissioner and Chairman, Conference of State Bank Supervisors
Kristie K. Elmquist: Regional Director, FDIC-Dallas Regional Office