February 11, 2019

By Email to Comments@fdic.gov

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Robert E. Feldman, Executive Secretary

RE: Marketplace Lending Association Comment on RFI on the FDIC's Deposit Insurance Application Process (RIN 3064-ZA03)

Dear Sirs and Madams:

The Marketplace Lending Association ("MLA")[1] appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's ("FDIC") request for information ("RFI") regarding the deposit insurance application process.[2] MLA commends the FDIC for seeking views on the deposit insurance application process, and specifically on how to improve the process for applicants that seek to form insured banks that are not traditional community banks. We also strongly support steps the FDIC has already taken to improve its application process, such as its recent establishment of a process to accept and provide feedback on draft application materials, which will significantly aid applicants in developing business plans and policies that are consistent with the statutory factors for approval.

Many MLA members and other financial technology ("fintech") companies already partner with banks to help provide credit and other financial services to underserved consumers and small businesses. In these cases, the bank partner sets the loan underwriting criteria and maintains the direct supervisory relationship with state and federal prudential regulators. A number of fintech lenders are beginning to consider pursuing their own bank charter and deposit insurance to expand their ability to reach those constituencies by offering increased access to financial products and services. This would provide regulators with direct supervisory and regulatory oversight of these firms. Part I of this letter describes why the entry of qualified fintech companies into the banking system could benefit consumers and small businesses and further the mission of the FDIC as a regulator and deposit insurer.

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[1] MLA is an association of technology-enabled lending companies with a mission to promote transparent, efficient, and customer-friendly financial systems by supporting the responsible growth of marketplace lending, fostering innovation in financial technology, and encouraging sound public policy. Our members include two-sided platforms that connect borrowers and investors, technology-enabled platforms that lend from their balance sheets, and hybrids of these two models.

[2] 83 Fed. Reg. 63,868 (Dec. 12, 2018).

Unfortunately, certain aspects of the *de novo* chartering and deposit insurance application process that are designed for organizers of a traditional community bank can discourage a fintech company from applying to form a bank. Part II suggests modifications to the FDIC's application process, including its evaluation of applications, to support entry into the banking system of fintech lenders that offer innovative and customer-friendly banking products and services. Some of these changes also would improve the process for applying to form a traditional community bank. An evolution of the FDIC's deposit insurance application process will be vital for facilitating financial services innovation and meeting changing customer needs.

I. Entry of Qualified Fintech Companies into the Regulated Banking Sector Would Benefit Consumers, Small Businesses, and the FDIC

Congress has charged the FDIC with the mandate to review and approve deposit insurance applications from qualified *de novo* bank applicants because of the benefits that new banks provide. New banks bring fresh capital for lending into the banking system, while new ownership and bank management teams can bring fresh ideas in the form of innovative technologies, processes, and human capital. This cycle ensures a healthy, dynamic, and competitive banking system that supports the rapidly-evolving financial needs of consumers, businesses, non-profits, and government entities, ultimately strengthening the U.S. economy in the long term.

From this perspective, fintech companies' entry into the banking system would produce substantial benefits:

- ***Innovative underwriting, products, and services.*** Fintech companies have spent years developing innovative technology, analytics, and customer service that serve a broader and deeper segment of the consumer and business markets with safe, transparent, lower-cost, and more convenient financial products. Whether in competition or partnership with fintech companies, banks have responded by refocusing their attention on how to better serve their customers in similar ways via digital offerings. Fintech lenders have also introduced to the marketplace new products, such as student loan refinancing, that traditional banks were not offering. In these ways, innovation by fintech companies already has provided borrowers with competitive product options and a lower cost of credit.

- ***Increased access to credit.*** Fintech companies can provide credit to underserved consumers and businesses on fair terms. These are customers traditional banks may not be reaching due to antiquated technology, a lack of digital product offerings, legacy underwriting systems, a user experience that does not meet the expectations of today's borrowers, or other factors. Many fintech companies have deep expertise in developing and using underwriting analytics and algorithms that can benefit borrowers who are creditworthy, but who have limited credit history and therefore may not be able to obtain a loan from a bank that relies only on traditional underwriting criteria.

- ***Expanded lending abilities.*** By gaining access to deposit funding, fintech companies that charter insured banks would likely decrease their funding costs and expand their focus on product innovation beyond lending. This would position such companies to increase the supply – and lower the cost – of the credit they make available to borrowers, as well as expand access to additional banking products and services.

- ***Flexible balance sheets.*** A pure marketplace model differs from the traditional balance sheet model of lending in that each loan is matched through the marketplace with capital from investors. Those investors, rather than the fintech company operating the marketplace platform, earn the interest income from the loans and bear the associated risk. To the extent fintech companies continued to use this model after acquiring bank charters, the model would promote their safety and soundness by decreasing their credit risk and liquidity risk (because of reduced maturity transformation between short-term deposits and long-term loans).

- ***Geographically dispersed lending.*** Without alternatives to traditional banks, the banking system risks becoming static, which could increase risk to the financial system and to the real economy. Banks that concentrate their lending in particular geographies are exposed to their local economies, and conversely, can harm their local economies when they fail. In contrast, banks with business models built for the digital age are likely to be more diversified geographically, which can help ensure a healthy banking system by providing support for the deposit insurance fund if traditional banks fall on hard times based on local economic conditions. This diversification will promote a healthy economy by filling credit gaps in areas affected by bank failures and in banking deserts. There is ample room in the banking system for both traditional and digital-first business models to coexist and complement each other.

- ***Known and regulated entities.*** MLA members currently are helping to fill gaps in credit availability to underserved borrowers by, among other things, partnering with banks. Bank-fintech lending partnerships are subject to robust supervision by the federal banking agencies under the Bank Service Company Act, and the FDIC has published detailed guidance for banks to follow in managing these relationships and agency supervisory staff to follow in exercising oversight over the relationships. This existing level of oversight ensures that fintech companies' products and services are safe and transparent for consumers. Bringing mature and successful fintech companies deeper into the regulatory perimeter by granting them bank charters and insuring their deposits would provide the federal banking agencies with greater oversight over such companies' activities and a better understanding of the opportunities and risks of new technologies. Additionally, fintech companies that acquire a bank charter would increase the transparency and accountability of their operations by directly complying with the reporting and other requirements that apply to banks.

In sum, bank charters with deposit insurance would amplify the benefits that fintech companies are already providing consumers, small businesses, and the financial system as a whole. The FDIC, as a gatekeeper to the banking system, should encourage qualified fintech companies to obtain bank charters and seek to minimize artificial barriers to such companies obtaining deposit insurance.

II. The FDIC Should Modify its Deposit Insurance Application Process to Support Entry of Qualified Fintech Companies into the Regulated Banking Sector

Certain aspects of the deposit insurance application process have discouraged qualified fintech companies from expending the considerable time and resources that are necessary to complete the process. The FDIC should take a number of steps to reform the process and eliminate these unnecessary barriers.

A. Involve Staff with Fintech or Innovation Experience

In considering deposit insurance applications from fintech companies, the FDIC should deploy staff with fintech or innovation experience to complement the examination and applications expertise already devoted to *de novo* applications. Staff of the FDIC's new Office of Innovation could be used for this purpose.

An example of how staff fintech experience would improve the process is in the analysis of the profitability of a fintech company applicant. Technology companies typically have very different growth curves from traditional community banks. Successful technology companies typically lose money for several years as they acquire a critical mass of customers and can then experience strong earnings growth afterwards. In our members' experience, however, just the opposite is expected of charter applicants: agency staff expect a bank's projections to show early profitability, followed by slow and steady growth. A better understanding of fintech business models would not only increase the FDIC's comfort level with granting deposit insurance; it would also allow the agency to focus on and address any risks that differ from those presented by a traditional *de novo* bank applicant for deposit insurance.

B. Evaluate the Statutory Factors in Their Proper Context

Fintech companies may have non-traditional, technology-dependent ways of satisfying the factors prescribed in section 6 of the Federal Deposit Insurance Act, 12 U.S.C. § 1816. This is an area where participation of staff with expertise in fintech will be essential. To give some examples:

- Senior management of a fintech company may come from backgrounds in technology rather than in relationship banking. Depending on the business model of the prospective *de novo* bank, technology experience may be as relevant an indicator of "character and fitness" under section 6 as traditional banking experience.

- Fintech companies may define their "communities" differently than traditional community banks, and may have different, but no less valid, ways of serving the "convenience and needs" of those communities under section 6.

- Fintech companies' business models present different risks to the Deposit Insurance Fund than traditional community banks, which tend to have greater geographic and commercial real estate concentrations.

- As discussed above, the "future earnings prospects" of a technology company can be much greater than those of a traditional community bank, but (by design) take longer to come to fruition. Prior to profitability, fintechs should be given the opportunity to demonstrate financial strength and stability in alternative ways, such as additional capital or liquidity levels.

In this regard, we encourage the FDIC to update its Statement of Policy on Applications for Deposit Insurance, which is key guidance setting forth the FDIC's interpretation of the statutory factors. The FDIC last amended this guidance in 2002, before the widespread adoption of internet banking in *any* form. Alternatively, the FDIC could develop a new Statement of Policy tailored to deposit insurance applications from companies that are not traditional community banks. Doing so would underscore that the FDIC is open to modifications to its processes to facilitate applications from non-traditional applicants.

C. Coordinate Application Review and Field Investigation with Other Agencies

Because of the sheer number of regulatory agencies involved with a *de novo* application, each with its own timeline and potentially conflicting set of expectations, chartering a bank can be a labyrinthine process. To harmonize the process, the FDIC should coordinate its review of *de novo* insurance applications with the work of the chartering authority and, to the extent applicable, with the Federal Reserve as the regulator of any bank holding company or savings and loan holding company. Such coordination should occur as early as the draft application stage so that, to the extent the applicant needs to revise and adjust its plans, it can do so with input from each of the FDIC, chartering authority, and Federal Reserve.

Additionally, the FDIC should coordinate with the chartering authority in the field investigation to avoid unnecessary duplication of effort both by the regulators and the applicant and to help ensure that any needed changes based on the investigation can be satisfactory to both regulators. The FDIC should also coordinate with the other federal banking agencies to update the regulations implementing of the Community Reinvestment Act to account for the benefits that "branchless banks" can provide to communities nationwide.

D. Reduce Upfront Costs and Commitments

The FDIC's new willingness to provide feedback on draft deposit insurance applications is an important first step in reducing the upfront costs and commitments that are necessary for an applicant to secure approval, and the FDIC should explore further such steps. For example, the FDIC could provide preliminary conditional approval after the business plan has been submitted and determined to be consistent with the statutory factors, but before the applicant has completed steps such as drafting its final policies and procedures or hiring all of its management team. This interim approval would allow an applicant to make progress in the chartering process – and confirm the FDIC's basic comfort with the proposal – before the applicant engages expensive consultants to draft policies and procedures, makes substantial hiring commitments to round out the management team, finalizes all members of the Board of Directors, or leases real estate for bank headquarters.

E. Process ILC Applications Like Any Other Deposit Insurance Application, As Required By Law

Each of the benefits of bringing qualified fintech companies into the banking sector described in Part I of this letter applies with equal force to industrial loan companies ("ILCs"). The ILC form of bank charter is well-suited to some fintech companies that want to enter the regulated space but seek to minimize duplicative compliance costs and maximize the resources they can make available to serve customers. Moreover, most fintech companies limit their business to financial activities, and therefore would not implicate broader policy questions about the separation of banking and commerce if they acquired ILC charters.[3]

In the past, however, the FDIC has not been willing to grant deposit insurance to new ILCs, even though the Dodd-Frank Act's moratorium on ILC deposit insurance applications has long since expired. We urge the FDIC to reverse course in this regard and, consistent with Chairman McWilliams's mandate, "give each ILC application due consideration."[4]

The FDIC also has established a practice of replicating many requirements that apply to bank holding companies and their investors in the context of ILCs, without any statutory basis for doing so. For example, the FDIC has required the parent company of an ILC to make capital-related commitments through a master operating agreement, despite the fact that such companies are not subject to capital requirements by statute or regulation. The FDIC has also required major investors to enter into passivity commitments to avoid exercising "control" over an ILC, even though the purpose of such commitments is to prevent an investor from becoming a bank holding company without obtaining prior approval, a consideration that has no relevance in the context of an ILC. The FDIC should end these practices.

Together with the other recommendations described throughout this letter, these changes to the FDIC's process would encourage more qualified fintech companies to apply for a bank charter and deposit insurance, and thereby yield the benefits of bringing them into the banking system.

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3 Typical venture capital funding structures can result in "control" of fintech companies by their investors under the Bank Holding Company Act even where those investors are passive, and venture capital funds generally cannot operate their investment businesses while subject to the strictures of section 4 of that Act.

4 American Banker, Four Takeaways From Grilling of FDIC, Fed Nominees on Hill (Jan. 23, 2018), *available at* https://www.americanbanker.com/news/four-takeaways-from-grilling-of-fdic-fed-nominees-on-hill.

Thank you for allowing us the opportunity to provide feedback on the FDIC's deposit insurance application process and for the agency's continued engagement as it seeks to enhance the process. If you have any questions, please do not hesitate to contact me at nat.hoopes@marketplacelendingassociation.org or (202) 662-1825.

Sincerely,

Nathaniel L. Hoopes
Executive Director
Marketplace Lending Association