National Association of Industrial Bankers
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October 18, 2021

Via Electronic Mail
Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20h Street & Constitution Avenue,
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Chief Counsel's Office
Attention: Comment Processing
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James P. Sheesley
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Federal Deposit Insurance Corporation
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Re: Request for comment on Proposed Interagency Guidance on Third Party Relationships – [Risk Management, 86 Fed. Reg. 38182 (July 19, 2021) (FRB Docket No. OP-1752; FDIC RIN 3064-ZA26; OCC Docket ID OCC-2021-0011).

To whom it may concern:

The National Association of Industrial Bankers (NAIB) appreciates the opportunity to submit comments from our member banks regarding the Proposed Interagency Guidance on Third Party Relationships (the "RFC").

NAIB is an association of industrial banks (IBs). Industrial banks, first chartered in 1910, operate under a number of titles; industrial loan banks, industrial loan corporations, or thrift and loan companies. These banks engage in consumer and commercial lending on both a secured and unsecured basis. They do not offer demand checking accounts but do accept time deposits, savings deposit money market accounts and NOW accounts. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including in some of the most underserved segments of the US economy. Industrial banks are state chartered FDIC-insured depository institutions that comply with the same state and federal laws and regulations that apply equally to all FDIC- insured banks. These same institutions are also commonly referred to as Industrial Loan Companies (ILCs).

We understand the importance of managing third party relationships in a safe and sound manner. We hope the following comments will be helpful in developing well balanced and effective guidelines.

All of our member comments expressed concerns about the new guidelines adding regulatory burdens that may be overkill and without adequately considering the impact on the banks. Some of our members remain unclear about what degree of due diligence will be required for providers of office supplies compared to a cloud servicer. In view of the literally millions of such relationships, almost all of which will present unique features and risks, our members have stressed the importance of allowing the banks a broad degree of discretion to judge criticality and the measures that need to be taken to identify and manage the risks in each third party relationship. The best way to address this subject may be by developing a list of basic standards for different types of relationships then allowing the banks to decide how they should be weighed and what more, if anything, is needed in each instance. We understand that it will be difficult to develop a list of things that should be considered when they may be appropriate to a particular vendor without requiring that kind of analysis in every instance, but the extent to which the guidelines will succeed depends to a large degree on that balance.

This is especially important for smaller banks. While each regulation may have its own purpose and benefits, the growing volume of laws, regulations and guidelines can pose a threat to the efficiency of all banks, especially small banks. It also impacts the ability of large banks to compete with non banks. This growing aggregate burden has become a significant risk in itself and requires careful consideration in developing a new rule or guideline.

At the same time, our members want to convey their appreciation for the assistance regulators provide in pointing out what other banks have learned in selecting and managing third party services. This represents one of the biggest benefits of the regulator relationship. Our banks look forward to receiving such assistance in the future.

Turning to specific comments, the following is typical of what our members had to say:

> The suggested due diligence reads much like an acquisition due diligence list for acquiring another firm. While that may be appropriate for the most complex types of relationships, for the vast majority of third-party relationships, this feels like overkill. The framework outlined should include more clear guidance on what constitutes well balanced risk management processes that are commensurate with the level of risk and complexity of third-party relationships.

Other comments from members include:

1. The level of due diligence contained in the proposed guidance needs to be pared back particularly where the bank has limited negotiating power and is unable to obtain due diligence materials. The current guidance requires exhaustive efforts to document the bank's efforts to obtain information and if unable to obtain information, determine alternative evaluation methods. We suggest that the proposed guidance focus on a bank's use of due diligence materials that are industry standard, understandable/comparable, and frequently available. SOC reports, Business Continuity Plans, Insurance

Certificates, etc. are acceptable for satisfying due diligence and ongoing monitoring requirements.

2. A matrix or other tool might be incorporated into examination manuals so that banks would have a baseline from which to work (see the FFIEC's Cybersecurity Assessment Tool as an example).

3. The focus of a bank's review of a third party's critical subcontractors (or 4th parties) should be on the third party's management of their own critical subcontractors, rather than the bank performing due diligence on the subcontractors.

4. Input from critical bank service providers should be incorporated into any final guidance to better understand what they are able and willing to provide for due diligence materials.

5. The final guidance should clearly specify all previous guidance that is being replaced (adopted or otherwise).

6. The CFPB should participate in the guidance (since it has its own guidance on service providers) so there is a single regulatory standard.

7. The concept of "critical activities" should be separated from "critical providers," as providers with a role in "critical activity" might not be a "critical provider" warranting full vetting and monitoring.

8. Further clarification is needed on the term "foreign-based" and how the guidance applies to subsidiaries of US Companies that are located in another country (or vice versa).

9. The guidance should allow Boards (or Board Committees) to receive initial and annual reports on critical vendors, rather than being involved directly in due diligence/contract approval at the time of onboarding.

10. Elements of the OCC FAQ's that are necessary for inclusion should be integrated into the relevant section of the proposed guidance. Having separate FAQ's introduces confusion.

One bank suggested that the agencies adopt the principles/guidance in the FDIC's proposed FIL 50-2016.

Another member described an experience at a national bank when OCC examiners pressed the bank to conduct more thorough due diligence on third parties from which the bank buys loans, such as car dealers. Some banks buy loans from as many as 14,000 auto dealers. It is not feasible to conduct the level of due diligence described in the proposed guidelines on that many businesses. That member stresses that the exclusion for original creditors selling loans to a bank should be continued.

One issue mentioned by most commenters that we feel needs a much broader discussion is management of relationships with critical vendors that serve many banks and do not allow extensive due diligence, visitation, audit or customization of services because it is impractical. For example, some core processors serving hundreds of banks are not subject to rigorous oversight by their bank customers or regulators. As noted in the RFC, some are examined by regulators but the findings can only be shared with the banks that already use that vendor. Some of these entities arguably qualify as a SIFI. If they failed a significant portion of the banking industry would suddenly be unable to process transactions and serve their deposit and merchant customers. To an extent banks evaluating options for such crucially important services must simply trust that the servicer is stable and well managed and poses no significant risk of failure or breach. It is particularly noteworthy that the regulators have no plan, and possibly no authority, to place such a critical vendor in receivership and continue its operations in a crisis. In the view of many of our members, this has developed into one of the biggest risks in the banking system and as a practical matter it is one only the regulators and government can fully address.

While acknowledging the importance of trade secrets to many businesses, we feel that regulators should at least request, if not require, critical service providers such as core processors to authorize regulators to share all or edited copies of regulator examination reports on those critical service providers with banks or bank applicants conducting due diligence to select or oversee such a critical service provider. One member added: "It would be helpful if regulators shared on a timelier basis issues/concerns they have so that banks can incorporate in their due diligence monitoring."

We have also encouraged individual banks to submit their own comments and we will not repeat those comments here but hope you find those helpful as well.

We appreciate the opportunity to submit our comments and hope they are useful.

Sincerely,

[redacted]

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