Friday, May 24, 2019

The OCC’s Semiannual Risk Perspective report focuses on key issues that pose threats to bank safety and soundness and legal compliance. Among such issues discussed in the Spring 2019 report, which generally reflects bank data as of December 31, 2018, are risks arising from financial innovation and new technologies.

One of the most significant issues discussed in the report involves artificial intelligence and alternative data, with the OCC highlighting the potential fair lending risks arising from these innovations. It stresses the need for bank management to understand and monitor underwriting and pricing models to identify potential disparate impact and other fair lending issues. The OCC observes that new technologies for evaluating and determining creditworthiness, such as machine learning, can add complexity while limiting transparency. It also advises bank management that they should be prepared to explain and defend underwriting and modeling decisions.

Other important observations made by the OCC in the report include the following:

- While innovation can enhance a bank’s ability to compete, changing business models or offering new products and services can elevate strategic risk when pursued without appropriate corporate governance and risk management. Banks that do not assess business relevancy and impacts from technological advancement or innovation, or are slow adapters to industry change, may be exposed to increased strategic risk.
- A significant number of fintech and other nonbank companies provide products and services traditionally offered only by banks such as payment processing, retail loans, and small business banking, and have the ability to provide accelerated payment availability and loan approval. As a result, borrowers are increasingly turning to fintech lenders for unsecured personal loans, with fintech lenders going from the lowest to the top originators of unsecured personal loans in just over three years. While competition from fintech companies is increasing in other areas such as mortgage and small business lending, fintech companies have not yet gained a similar level of market share outside of unsecured loans.
- By taking a wait and see approach to innovation, banks add to their risk. This is because the speed of change, combined with the lengthy process to evaluate and implement new technologies, can result in the loss of customers or market share. Banks should focus on their core competencies and identify compatible opportunities and technologies that increase efficiency and reach customers effectively. Smaller banks seeking innovative solutions may find their business models adaptable to collaboration with a nonbank to strengthen bank operations and customer acquisition.
- When collaborating with a nonbank to offer innovative products and services, the nonbank’s practices should be subject to initial and ongoing due diligence and appropriate oversight.
- Bank management should properly manage the risks arising from relying on third-party service providers for critical functions such as payments, transaction processing, or maintaining sensitive information, or to supplement and support compliance operations.
- The OCC has linked many consumer compliance risk management concerns to weaknesses in change management processes, such as a failure to involve the compliance function when evaluating changes in, or additions to, products or services.
- Internet, mobile banking, fintech, and other asset and wealth management providers have increased their...
offers of low-risk, higher-yield products that directly compete with bank deposits. To maintain customer satisfaction, less sophisticated banks may need to invest in technology that matches the online and mobile banking capability offered by other institutions.

The OCC recently announced its plans to open its own “sandbox” through a Proposed Innovation Pilot Program designed to promote its innovation initiatives, add value through proactive supervision, and continue its objective to lead fintech innovation expansion. The comment period for the proposal is open until June 14, 2019.

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