

Know your fintech: Banking agencies issue guide on conducting fintech due diligence

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The Federal Reserve, FDIC and OCC jointly issued a due diligence guide for community banks for assessing potential relationships with fintechs. Our client update examines the implications of the guide for both banks and fintechs.

Background

The Federal Reserve, FDIC, and OCC (together, the Agencies) have jointly published [Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks](#) (the Guide). While the Guide is framed as a tool for community banks, there is insight to be gleaned from the Guide by fintechs as well.¹ In addition to being a useful guide for banks, the Guide should allow fintechs to gain a better sense of the information and documents they should have in hand, as well as the approach they should take, when aiming to partner with banks. For example, as discussed below, a fintech should: develop strategic plans focused on third-party relationships with banks; highlight the experience and qualifications of its staff; be prepared to demonstrate long-term financial stability; and develop comprehensive internal control, legal compliance, and risk management frameworks that align with those of banks.

The Guide follows the Agencies' recently published [proposed interagency guidance](#) (the Proposed Guidance) concerning how banking organizations should manage the risk associated with their third-party relationships, which Davis Polk addressed in another [client update](#). The Proposed Guidance is applicable to banking organizations' third-party relationships generally, addressing "any business arrangement between a banking organization and another entity, by contract or otherwise." In contrast, the Guide focuses squarely on community banks' relationships with fintechs. Nevertheless, the Guide expressly notes that it draws from the Agencies' existing guidance on third-party relationships and is consistent with the Proposed Guidance.

The Guide was itself followed by the Federal Reserve's publication of a paper titled [Community Bank Access to Innovation through Partnerships](#), which provides a framework for understanding partnerships between community banks and fintechs, and what makes those partnerships effective. Davis Polk addressed this publication too, in a separate [client update](#).

The Agencies' recent publications are responsive to, as the Guide puts it, "innovation and evolving customer preferences that are changing the financial services landscape," brought about in part by both the increasing prevalence of fintechs as well as the growing number of relationships between fintechs and banks. The issuance of the Proposed Guidance and the Guide in relatively quick succession may signal that third-party risk management, and in particular risk management of relationships involving fintechs, is an area of increasing supervisory focus for the Agencies.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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¹ The Agencies note that “the fundamental concepts may be useful for banks of varying size and for other types of third-party relationships.” Accordingly, we use the terms “community bank” and “bank” interchangeably in this client update.

² The Guide includes one additional sub-topic not discussed in this client update because it is not a due diligence topic—“service level agreements.” In that sub-section, the Guide explains that when negotiating the agreement that will ultimately govern the relationship between a bank and a fintech, a bank should ensure that the terms are both reasonable and adequately tailored to the nature of the relationship and activity.

The Guide

Due diligence as a component of third-party risk management

Key due diligence topics

Business experience and qualifications

Business experience

Business strategies and plan

Qualifications and backgrounds of directors and company principals

Financial condition

Financial analysis and funding

Market information

Legal and regulatory compliance

Legal

Regulatory compliance

Risk management and controls

Risk management and control persons

Information security

Information security program

Information systems

Operational resilience

Business continuity planning and incident response

Reliance on subcontractors

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