July 12, 2016

Testimony of

Rob Nichols

On Behalf of the

AMERICAN BANKERS ASSOCIATION

before the

Financial Services Committee

Subcommittee on Financial Institutions and Consumer Credit

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Chairman Neugebauer, Ranking Member Clay, my name is Rob Nichols, and I am President and Chief Executive Officer of the American Bankers Association (ABA). The American Bankers Association is the voice of the nation's $16 trillion banking industry, which is composed of small, midsize, regional and large banks that together employ more than 2 million people, safeguard $12 trillion in deposits and extend nearly $8 trillion in loans.

The topic of today's hearing is a timely one. New technologies are quickly changing the ways all businesses connect with their customers. "Fintech" is a term used to capture this convergence of banking and technology. While it has been used to refer to tech-focused startups, innovative technologies are offered by banks and startups alike. While many of these technologies may feel new, they typically leverage new technology as a delivery channel for traditional banking products and services.

Banks have always embraced innovation and continue to do so in order to better serve their consumers. Make no mistake, banks are pro-innovation, pro-consumer, and are very technology focused. Banks have pioneered important innovations in banking, such as ATMs, credit cards, online banking, and remote check deposit. Banks continue this innovation today, investing billions of dollars annually into technology to bring their customers the latest apps delivered through secure and trusted channels. Besides developing their own new products and apps, often through their own "innovation labs," banks are actively partnering with fintech startups to bring their customers the latest technologies.

When banks innovate and partner with startups to deliver new technologies their customers win. Many startups have developed innovative and intuitive platforms that give customers new ways to access to their financial services. Banks have a long history of serving customers needs and have established trusted relationships. These relationships are backed by a culture of compliance and regulatory oversight that ensures customers are protected. When innovative products are delivered through bank channels customers get a great experience backed with a relationship they can trust.

This is why the banking industry supports policies that empower banks to innovate and enable them to partner. If they are better able to integrate these technologies, customers will have greater access to safe, innovative technologies.

It is important to note that while technology can drive innovation and add value, it is not a replacement for a community presence. Community banking is a relationship business that is not replicable by technology. While banks are driving technological innovation, they remain a visible presence, supporting their local communities as they always have through community outreach and countless hours of volunteering – something that cannot happen through a key stroke or algorithm.

In my testimony today I will stress the following three points:

- Banks are innovating and partnering,
- When banks innovate customers win; and
- Innovation forward policies will benefit customers.

Financial technologies present tremendous opportunities to customers and banks alike. They have the potential to promote financial inclusion, giving greater access to financial services on better terms. They also have the potential to give customers better transparency into their financial services offerings and to enable the extension of credit to more creditworthy borrowers.

These benefits are only possible if we empower banks to innovate and partner with startups. Banks invest billions of dollars into innovations today that have the potential to benefit consumers and businesses. These innovations will only add value if banks, startups and regulators can collaborate. ABA stands ready to work with Congress and regulators to help facilitate this.

I. Banks are Innovating and Partnering

Today, banks of all sizes are innovating and partnering with technology-powered startups to deliver innovative products and services to their customers. Banks are investing significant resources into developing new technologies. They invest tens of billions of dollars annually into technology, much of which is devoted to new financial tools and apps. Security of customer information tops the list of investments, followed by data analytics, payment applications, and new mobile and online banking apps. A number of banks have established "innovation labs" to develop new products and apps. For example:

- A mutual bank in New England recently announced its "Express Business Loan," which allows small-businesses to apply for a loan, get approval, and receive funding all online and in less than three minutes.

- A parent company of a bank in the Northwest recently formed a collaborative bank innovation lab focused on advancing bank innovation.

Partnerships to Move Forward

Banks and startups both have a unique set of strengths. When the two collaborate they are able to deliver their customers the best, most innovative products through a trusted secure channel.

Fintech startups also bring a culture of innovation. Their technology expertise and ability to experiment has allowed them to build a digital customer experience without some of the constraints faced by banks.

Banks bring tremendous value to the table that is not replicable by startups, the most important being their role as trusted custodians of their customers' money and information. Banks have established a strong level of trust with customers that is necessary when handling someone's money. This trust is backed by a strong culture of compliance and a regulatory framework designed to protect customers. Establishing and growing customer relationships is the largest challenge for startups. Banks have stable deposit funding which gives them resiliency to offer innovative products throughout shocks and credit cycles.

Through collaboration and partnerships, banks and startups can deliver the best technology-forward products to customers. Examples of these partnerships include:

- **Small Business Lending** – One bank recently entered into a partnership with a marketplace lender to build a new small-dollar lending product for their small-business clients.
- **Consumer Lending –** A regional bank in the South partnered with a provider of personal loans to offer a "streamlined" online loan application and underwriting experience for their bank customers, and partnered with another firm to provide online loans to small businesses.

New Interface, Traditional Products

At their core, most innovations in financial services today closely resemble traditional banking products and services. The innovations being implemented today leverage new, digital delivery channels for these products to give customers faster, more convenient access to these traditional products.

Consumer and small business lending is critical to the American economy. Online lending is just a new delivery channel for a product that has existed for many years. ABA member banks have always provided consumer loans that help families reach their financial goals and the small business loans that drive local growth and job creation.

Marketplace lending is a catch-all term that typically describes online lending offered by non-banks. These lenders provide online interfaces that allow customers to apply for, and receive credit quickly and easily. They fund these loans in a number of ways. Although many lenders act as a "marketplace," matching borrowers with investors, many others originate loans that they hold to maturity. Moreover, a number of banks also offer online application and approval for loans.

The loans being originated by online non-bank lenders closely resemble traditional loans. They are typically fixed rate, term based (with maturities ranging from 36-60 months), and are fully amortizing (with the loan paid-off at the end of its set term).

Online lenders typically target traditional borrowers. Although online platforms have the potential to expand credit access, to date these platforms have done little to serve unserved or underserved borrowers. Lending Club, for example, has a minimum credit requirement that requires a FICO score of at least 660, with 78 percent of their loans being made for refinancing existing debt.

Relationship Banking Not Going Anywhere
While digital channels can add significant value for many customers, they are not for everyone. The high-touch relationship banking that banks, particularly community banks, offer are critical to communities across the country and are not replicable by technology.

A personalized approach allows banks to truly understand their customers and work with them, tailoring products to meet their specific needs. In his remarks on responsible innovation, Comptroller Curry noted concerns about customers relying solely on online lenders. "I would worry about the staying power of some of the new types of lenders. One of the great virtues of community banks is that they know their customers and they stand behind them in good times and bad. I'm not so sure that customers selected by an algorithm would fare as well in a downturn."

There are a number of communities with limited access to the technology needed to take advantage of online financial services. The Pew Research Center estimates that 68 percent of American adults have access to smartphones in 2015 with 85 percent having access to the internet. These statistics show significant progress, but we cannot forget about the 32 percent of Americans without smartphones and the 15 percent without internet access. These statistics become much more pronounced when looking at low income and rural communities. Community banks stand ready to serve these communities as they always have.

II. When Banks Innovate Customers Win

Innovation in financial services has the ability to benefit consumers across the country and drive growth in our economy. New technologies allow financial service firms to connect with customers in new ways and offer them products that may better fit their needs. It can lower the cost of financial services, making more affordable options available to consumers across the country. It provides added convenience and efficiency, giving customers the ability to manage their finances day or night from the palm of their hand. Technology can also lower the fixed costs for providing credit to small businesses, leading to greater capital access that spurs economic growth. As part of all of these innovations, banks continue to assure that customer information is protected.

Banks have served as a trusted provider of financial services for centuries and take that role very seriously, whether those services are provided in traditional channels or through new online and mobile applications.

Customer Protection Comes First

To customers, a loan is a loan. When making financial decisions, consumers expect the same level of protection regardless of the provider. Federal law provides for numerous protections for consumers when they borrow, and they expect this same level of protection in all financial services interactions.

Banks operate in a heavily regulated environment that ensures all new products are safe before they get into a customer's hands. Banks have robust risk controls around these products that ensure customers are protected. This culture of compliance leads to better outcomes for consumers. This strength equates to market confidence and builds trust.

Contrary to popular belief, the rules governing lending generally apply to banks and nonbanks alike. Consumer protection laws apply regardless of provider. Moreover, all small business loans are subject to a number of rules to ensure customers are treated fairly.

Despite these protections, it is impossible to deny that customers receive a different experience when they go to a bank versus a non-bank lender. Only 15 percent of small businesses who went to online lenders for financing in 2015 reported being satisfied with the lender compared to 75 percent satisfaction from those who went to banks. Top frustrations with non-banks were high interest rates (70 percent) and unfavorable repayment terms (51 percent).

The key differences leading to positive customer outcomes at banks are: (1) a long history of serving customers and the community; (2) a culture of regulatory compliance with regulations; and (3) effective oversight—including stringent and regular examination—by state and federal agencies proactively addressing concerns before customers are impacted negatively. Oversight would ensure more transparency in non-bank online lending that would lead to better outcomes for customers.

We urge policymakers not to apply new small business protections to both banks and non-banks and instead focus on the differences between the two that lead to very different outcomes, namely oversight. Today, online lenders comprise just 5 percent of the small business lending market. Problems that are emerging in the small percentage of online loans should not drive radical and unnecessary changes that risk impairing a market that has served business customers well for decades.

Today, there are a number of non-bank online lenders adhering to sound lending practices and serving their customers well. Constructive oversight will help them provide better service to their customers. Oversight also will identify and capture bad actors.

When banks partner with online lenders they ensure compliance with the many rules and regulations. Banks are required to fully vet all of their non-bank partners through third party vendor management guidelines. This relationship means that products offered in coordination with banks are often subject to greater oversight.

Fintech Charter

There is much discussion regarding whether there is a role for a non-bank federal charter. The OCC is conducting a careful analysis of the issues associated with this. As they proceed with this process we urge policymakers to consider the following points:

Charter Purpose – Regulators should examine the specific nature of the charter being requested and how it compares to an existing bank charter. The OCC has been given authority to charter federal institutions that serve a public purpose. The federal bank charter serves such public purposes today. Regulators need to consider how a proposed charter would differ from existing bank charter options and why a different regulatory approach is necessary. It should also examine whether those differences serve a public purpose.

A federal charter comes with a responsibility to continue serving a public purpose. Today banks have an obligation to serve the public good and demonstrate their performance (such as complying with the Community Reinvestment Act). Any non-bank charter should have an affirmative responsibility to meet their charter purpose and have similar standards of performance consistent with the public policy goals of the charter.

Consistent Protection – Any new charter must ensure that customers are adequately protected. When customers receive financial services they expect consistent levels of protection, regardless of the provider. Any such charter must provide the same level of consumer protection and oversight as a federal bank charter. It should not be considered a path to avoid regulation.

OCC Comptroller Curry is well aware of this issue, commenting that, "companies operating with a federal charter or in partnership with a federally chartered bank are sound and comply with basic consumer safeguards that apply to all creditors. I would be very concerned, for example, if we were to authorize a federal license that offers the benefits of the national bank charter, including preemption, without any of the safeguards or responsibilities that apply to banks and thrifts."

III. Innovation-Forward Policies Will Benefit Customers

Regulation Should Be Based on Activities

The nature of the activities that a company facilitates, not the company structure, is what matters. Good regulation helps identify and control for risks. Many innovations, at their core, are traditional banking products offered in new ways. By focusing on the activity taking place, regulators are best able to assess the risks being presented to consumers and the system.

Effective oversight can help financial providers identify compliance gaps before there is consumer harm. More importantly, oversight is needed to ensure that malicious actors do not take advantage of customers.

Partnership to Move Forward

A modern high-tech banking system requires a modern set of rules. Many laws and regulations were written well before today's technologies existed and will need to be updated to ensure they are true to their original intent by not omitting new technologies and delivery channels, and not restricting innovation by mandating specific technologies or limiting partnerships.

A Sandbox for Innovation

Many participants have suggested a "sandbox," that allows banks and non-banks to test new products, to help facilitate innovation in financial services. A sandbox is a broad analogy that means many things to many people. ABA believes that with the right parameters, a testing ground for new products can help facilitate innovation.

Greenhouse Approach – Although the term sandbox is commonly used to describe a testing ground for new products, a greenhouse is a better analogy. A sandbox is a playground that allows for experimentation with ideas that may have little real-world applicability. A greenhouse provides shelter for seedlings of ideas, giving them the right level of attention and care with a plan to introduce them to the real world as they develop. An effective testing ground for new products should facilitate development of products and services that have real world applicability with a development plan for a full roll-out to real customers.

New Products – A testing ground for new products only facilitates innovation if it allows companies to test new products in a way that they are unable to today. A program that only allows for piloting traditional products that banks have the authority to offer today risks adding another level of regulation which will prevent banks from introducing innovative products.

Our Vision – ABA believes that the creation of a "greenhouse" program – allowing companies to test new products on a limited scale – would facilitate innovation both inside and outside of the banking industry. A successful program would balance ensuring that participating customers are protected while limiting the compliance burden associated with testing a new product.

This program would require certain exemptions from existing compliance obligations. Today, implementing a full compliance program makes piloting many new products cost prohibitive. Participants in this program would work with regulators to develop rules and guidelines for the products covered. Customers would need to opt in and have full disclosure of the risks involved in a given product. Moreover, if customer harm is done, the individuals that were harmed must be made whole; however, participating banks should not be subject to sweeping fines as a result of programs that do not work as intended.

In practice this means that if, for example, a pilot did not meet customer needs, the program should be adjusted or canceled. The bank that piloted the program should have no further punishment for trying the product.

Conclusion

Financial technologies are quickly changing the way that customers connect with banks. These technologies have the potential to benefit consumers greatly, giving them better access to financial services on their terms. Banks are embracing this, developing new products and partnering with startups to deliver their customers the latest technologies. Customers benefit most when innovative products are delivered through safe, trusted channels. Smart policies will empower banks to innovate and partner to deliver the latest technologies to customers.