

community BANKER

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Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

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The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

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COMMUNITY BANKER is designed to share ideas and developments related to the field of banking. It is not intended as legal advice and nothing in the COMMUNITY BANKER should be relied upon as legal advice in any particular matter. If legal advice or other expert assistance is needed, the services of competent, professional counsel should be sought.



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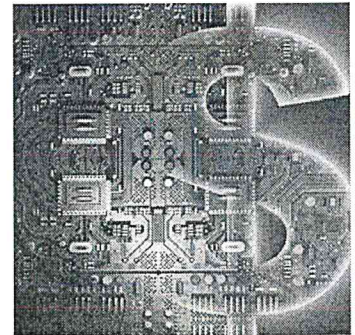
AGENCIES RELEASE DUE DILIGENCE GUIDE FOR COMMUNITY BANKS

On August 27, 2021, the Federal Reserve, the FDIC, and the OCC issued a 20-page guidance titled “CONDUCTING DUE DILIGENCE ON FINANCIAL TECHNOLOGY COMPANIES - A GUIDE FOR COMMUNITY BANKS.” Written from a community bank perspective, the guide addressed the different categories of due diligence a community bank should undertake if it is considering collaboration with financial technology companies or “fintechs.”

By providing access to new or innovative technologies, companies specializing in financial technologies can offer community banks many benefits - enhanced products and services, increased efficiency, and reduced costs – all of which increase competitiveness. However, like any other third-party relationships, arrangements with fintech companies can also introduce risks. Assessing the benefits and risks posed by these relationships is key to a community bank’s due diligence process. The diligence guidance is intended to be a resource for community banks when performing due diligence on prospective relationships with fintech companies. Note that the use of the guide is voluntary (and not a requirement or rule) and it doesn’t predict *all* types of third-party relationships and risks. However, a community bank can tailor how it uses relevant information in the guide based on its specific circumstances, the risks posed by each third-party relationship, and the related product, service, or activity offered by the fintech company.

The guide suggests that community banks conduct due diligence with respect to fintechs in six key due diligence topics: (1) business experience and qualifications, (2) financial condition, (3) legal and regulatory compliance, (4) risk management and controls, (5) information security, and (6) operational resilience.

The guidance presents subgroups for due diligence within each of the six categories, and offers relevant considerations for a community bank for each subcategory, potential sources of information, and illustrative examples. The key due diligence topics and subgroups include:



1. Business Experience and Qualifications

Business experience

Business strategies and plans

Qualifications and backgrounds of directors and company principals

2. Financial Condition

Financial analysis and funding

Market information

3. Legal and Regulatory Compliance

Legal

Regulatory compliance

4. Risk Management and Controls

Risk management and control processes

5. Information Security

Information security program
Information systems

6. Operational Resilience

Business continuity planning and incident response
Service level agreements
Reliance on subcontractors

Because increased use of a third-party relationship like fintech can create increased risk, the Federal Reserve, the FDIC, and the OCC make clear to banks that these types of arrangements do *not* reduce a bank's strict obligation to comply with federal consumer protection laws and regulations, the same as if the bank were to perform the service or activity itself.

Though the guidance is directed at community banks, it also provides fintechs with information as to what sort of due diligence a bank may undertake when it is considering an arrangement with a fintech. This should have your fintech stepping up its game in *every* aspect listed above in order to be competitive.

Bankers should review the guide located online in PDF form at

<https://www.federalreserve.gov/publications/conducting-due-diligence-on-financial-technology-firms.htm>

WILL YOU BE A “MARIJUANA BANKER” IN THE NEAR FUTURE?

Back in April, the House of Representatives passed the Secure and Fair Enforcement Banking Act of 2021 (the “Safe Banking Act”), which will, *if* passed by the Senate, create a safe harbor from federal prosecution and regulatory penalties for banks that provide financial services to cannabis-related legitimate businesses operating in cannabis-legal states. (Hello, North Dakota and medical marijuana!)



As you bankers know, cannabis is still illegal at the federal level under the Controlled Substances Act; cultivation, distribution, and possession of cannabis remains *federally* illegal, even if it is legalized by the states. Right now, a bank financing cannabis-related activities can face prosecution of crimes such as money laundering and unlicensed transmission of money. Not surprisingly, federally-insured banks that are examined by federal banking regulators are reluctant to work with cannabis-related businesses. Enter the Safe Banking Act, which, as currently written:

1. prohibits federal banking regulators from restricting, penalizing, or discouraging a bank from providing banking services to a legitimate cannabis-related business;

2. states that proceeds from a transaction involving activities of legitimate cannabis-related business are not considered proceeds from unlawful activity and so do not fall under anti-money laundering regulations or unlicensed transmission of money;
3. establishes that under federal law, banks are not subject to asset forfeiture for providing loans or other financial services to legitimate cannabis-related businesses;
4. forbids federal banking regulators from requesting or ordering a bank to end a bank/customer relationship with a cannabis-related business unless there exists a legitimate reason (such as protection of national security interests, preventing involvement with financing a terrorist organization, etc.); and
5. modifies reporting requirements for SARs and requires FinCEN to issue guidance on transactions related to cannabis-related businesses.

Supporters of the Safe Banking Act are optimistic that it will pass the Senate by the end of 2021 and are quick to point out that the Act will not legalize marijuana.