

Compliance Can Fuel Lending, Technology and Innovation

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Keynote Address

Online Lenders Alliance University

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Agenda

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Compliance
Value-add for
Online Lending



2. Online Lending Adds Value

Online Lending Adds Value

Guidepost agrees. Online Lenders provide:

- Speed-2-borrower
- Convenience
- Fuel for small businesses
- A financing alternative where banks have de-risked and exited clients



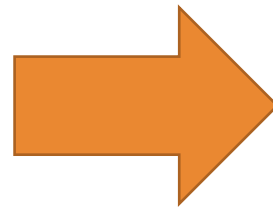
Financial Technology has disrupted banking ...

Disintermediation, disaggregation, and "De-Fi"



ABCD's of Fintech

- **Artificial** intelligence
- **Blockchain**
- **Cloud** computing
- **Big Data**



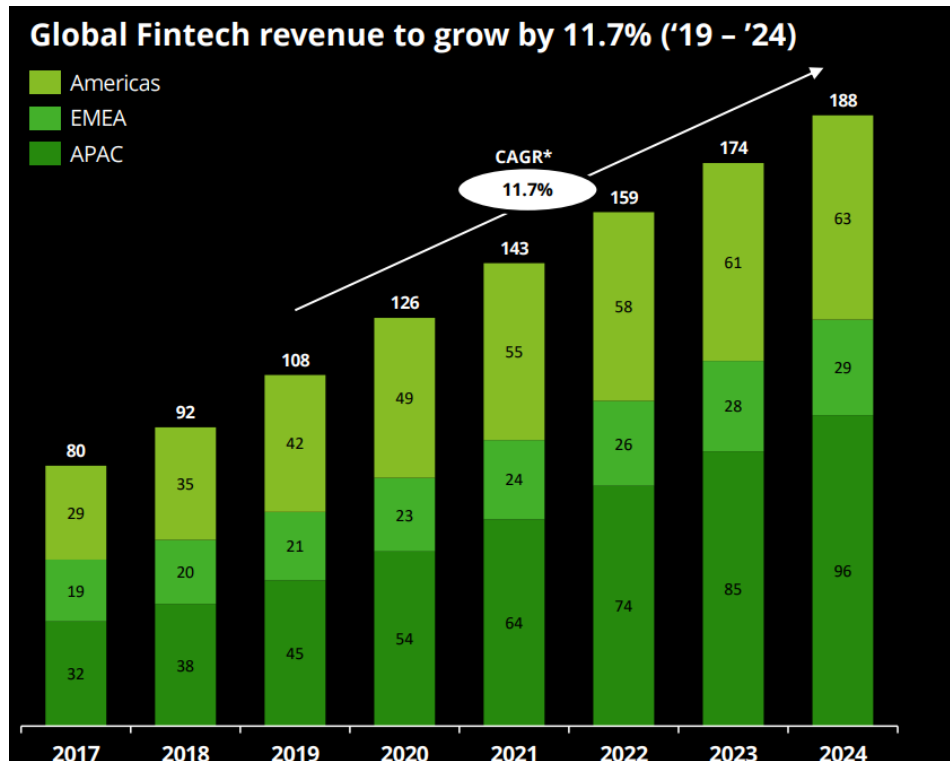
ABCD's of Banking and Finance

- **Anytime, anywhere**
- **Bitcoin** and digital assets
- **Contactless** banking, fueled by Covid
- **Democratization** of banking

Financial Technology has disrupted banking ...

... *But is now facing major economic and compliance headwinds ...*

Pre-Covid projections

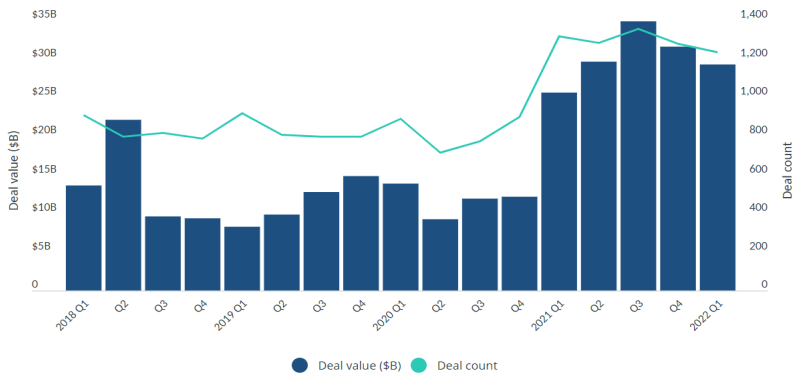


- Caught in **tech stock downdraft** (2022 - ?)
- **Fintech valuations have fallen** dramatically to four times forward revenue in May 2022.
- Interest **rates slowing some VC funding** and Fintech loan demand
- **Regulators treating Fintechs like banks**

As Fintechs mature, so are regulatory expectations

Venture capital funding of Fintechs is slowing

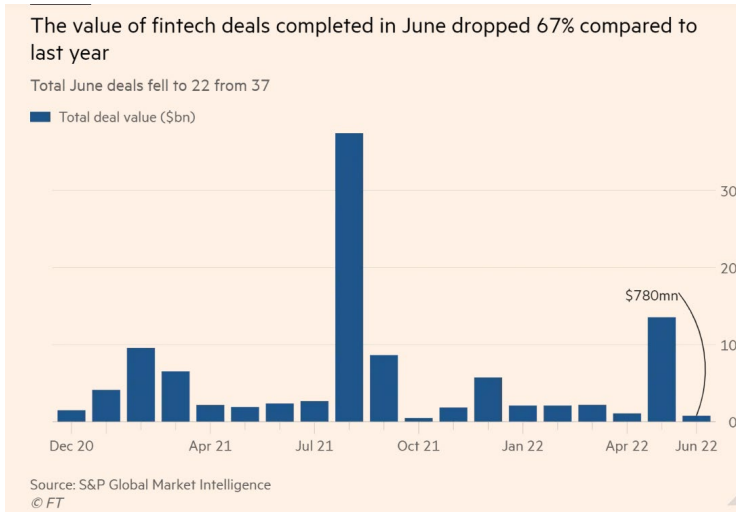
VC capital investment shows slight decline in Q1



As of Q1 2022

Source: Pitchbook.com

..And Fintech deals have declined



As of Jun 2022

As regulatory and customer expectations grow

Funding



Regulatory compliance expectations



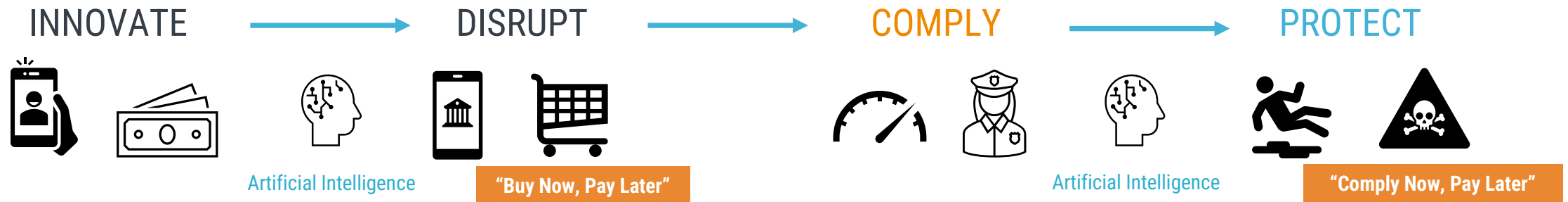
- **CFPB**
- **FTC**
- **OCC**
- **States, e.g., NY**
- **Non-US**
- **Dept of Justice**



3. Compliance Risks Growing

Financial Technology needs to comply like banking ...

... Especially as banks increasingly invest in and / or partner with Fintechs



ABCD's of Compliance

- **Anti-money laundering and Sanctions***
- **Business** continuity (and disaster recovery)
- **Consumer** choice and protection*
- **Data** on demand (by customers, regulators)



ABCD's of Compliance

- **Advertising** accuracy
- **Belief** and trust*
- **Cyber**-security*
- **Data** privacy

* Managing compliance risks (especially through a recession) → **business opportunity**

Money laundering and economic sanctions – Criminals exploit the weakest link in financial payments

Lending Red Flags

- ❏ Loans made for:
 - Ambiguous or illegitimate purposes
 - Or paid for, a third party
- ❏ Attempts to sever paper trail between the borrower and the illicit funds.
- ❏ Loans extended to persons located outside the U.S.
 - Higher-risk jurisdictions and geographies

Risk: laundering the proceeds of crime and financing terrorism

Payment Red Flags

- ❏ Anonymity (do we really know our customers?)
 - Submitting incomplete, misleading, or false information conceals their ID and avoid AML controls
- ❏ Speed of transactions:
 - Transferring large volumes of funds into / out of accounts or
 - Between different institutions quickly, outpacing the scrutiny of authorities

Risk: sanctions evasion / payments to enemy states, individual and entities including terrorists

AML and Sanctions Compliance Programs

Anti-money laundering

Five pillars of effective AML compliance

1. Policies and procedures / internal controls
2. Designated BSA compliance officer
3. Compliance training
4. Independent testing
5. Customer due diligence

Sanctions

Sanctions Compliance Program

1. Management commitment (culture)
2. Risk assessment
3. Internal controls
 - Policies and procedures to identify, interdict, escalate, report, and keep records
4. Monitoring and auditing
5. Training

You won't know your AML and Sanctions Risks unless you "know your customer" and your 3rd party vendors

AML and Sanctions Compliance Programs

Anti-money laundering

+ Sanctions Compliance = National Security

1. Do you risk assess your customer, by:
 - Geography?
 - Product / service?, and
 - Type of customer?
2. Know your vendor and partners:
 - Are your partner banks' controls effective?
 - How strong are your suppliers' and vendors sanctions controls?
3. Surveillance and reporting
 - Are you monitoring and independently testing effectively?
 - If exceptions arise, how are they escalated, investigated and addressed?
 - If violations or misconduct are found, do you self-report:
 - To your board?
 - To regulators?

1. Self-reporting matters, to escalate concerns, address risks
2. Filing suspicious activity reports matter, to safeguard all



Consumer Choice and Protection – Ironically, you'll be treated like a bank

Follow OLA best practices:

1. Educate your customers
2. Don't abuse, mislead or deceive
3. Protect customer data
4. Diligently prevent cyber crimes
5. Manage your vendors and partners



OLA Best Practices Overarching

- Ensure consumers are making educated financial decisions
- Give consumers a chance to change their mind by providing a clear and concise cancellation policy
- Be a company in good standing with the officials and regulators
- Never engage in activities that are unfair, abusive, or deceptive
- Protect every consumer's personal data with comprehensive security measures and do not share personal data in the same manner.
- Provide consumers with a copy of your privacy policy
- Help consumers help themselves by providing referrals to other lenders
- Use advertising and marketing practices that promote transparency and do not include deceptive advertising campaigns.
- Take applications from consumers and originate loans
- Ensure that payments are authorized and processed correctly
- Provide comprehensive website security and fraud protection, including monitoring for account use, and validation of routing numbers. All transactions must be verified.
- Never use threats, intimidation, or harassment to collect payments
- Appropriately manage third-party service providers to ensure they are compliant with all applicable laws and regulations



Consumer Choice and Protection – Are YOU a red flag to consumers and regulators?

Are you an online lending red flag?

- ❗ Credit discrimination
- ❗ Unfair and deceptive practices
- ❗ Excessive fees / rates
- ❗ Unclear / confusing disclosures
- ❗ Inaccurate reports to credit agencies
- ❗ Data not protected

Risk to Online Lender

- ❗ CFPB, FTC and / or other regulatory penalties
- ❗ Numerous customer complaints
- ❗ Customer litigation
- ❗ Poor publicity and reputational damage
- ❗ U.S. Department of Justice criminal prosecution
 - Fraud, identity theft, ineffective compliance

Consumer Choice and Protection – Complying is good business

Follow OLA best practices, and you'll:

1. Build trust and belief
2. Grow your bank partnerships
3. Gain regulatory confidence
4. Avoid criminal prosecution
5. **Safely grow and profit responsibly**



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4. Demystifying Compliance

Fintechs are vulnerable – with or without a bank charter or bank partnership

- As early as 2016, regulators calling for “responsible innovation”
- **Regulatory and reputation risk very high:**
 - As Fintechs embrace bank charters
 - As banks embrace fintech partnerships

CFPB Shuttles Lending by VC-Backed Fintech for Violating Agency Order

Google Ventures, Andreessen Horowitz, Kleiner Perkins, and other prominent venture capital firms invested in LendUp

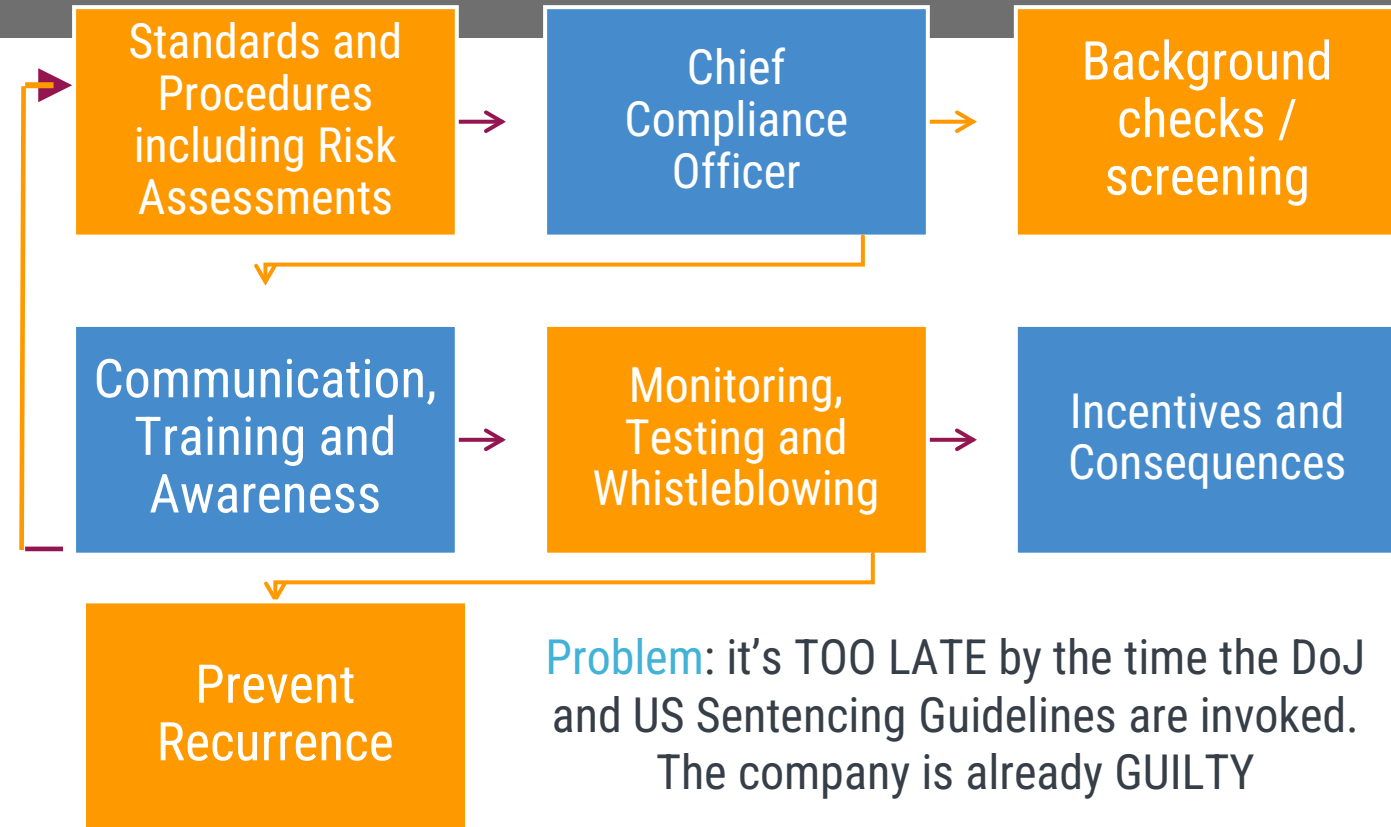
DEC 21, 2021



Fintech violations could be viewed as criminal, triggering U.S. Justice Department scrutiny

US Department of Justice - Seven elements of an “effective compliance program”

- **“Jail sentence” for guilty Fintech**
- **Seven elements** (see chart)
- **Deferred prosecution agreement (DPAs)**
 - Avoids criminality
 - Independent monitorship
 - **CEO and CCO certification**



- “Tone at the top” compliance culture is essential
- Risk-based controls
- Embed compliance risk into new products
- Accountability of business and technology execs



4. Compliance value-add for online lenders

Compliance adds value, gains trust and customers

Fintech proposition

- Speed-2-borrower
- Convenience
- Reach the under-banked
- Fuel small businesses
- Fill the void left by banks



Compliance proposition

- Known to protect customers
- Strong reputation attracts borrowers
- Secure Fintech = greater revenues
- Effective Fintech = national security
- **Comply now = profit and growth, responsibly**



HOW CAN WE HELP YOU?

CHALLENGE OR OPPORTUNITY, WE KEEP YOU MOVING FORWARD.

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Guidepost

WE ARE YOUR GUIDEPOST.