

Fintech Banking and SouthState



First things first..what is a Money Services Business (MSB)?

A "Money Services Business" or "MSB" is the term used by Financial Crimes Enforcement Network (FinCEN) to describe and identify businesses that issue or exchange currency, checks, and stored-value cards, including those entities that transmit money as part of their core business offering. MSBs must register with FinCEN at the federal level and then obtain licensure from each individual state regulatory agency that has purview over granting and administering Money Transmitter Licenses (MTLs) in their respective states. Typically, this falls under the jurisdiction of the state Banking & Finance Commission (or equivalent). This registration and licensure process is time-consuming and comes with significant expense.



Money Services Businesses, or "money transmitters", are defined in multiple ways. However, a core principle involves the transmission of client funds. The caveat for most fintech's is that these funds are owned by their customers and each state has its own interpretation of these activities and what exactly constitutes a money transmitter. Individual states have broad supervisory authority to regulate Money Services Businesses, with the objective of protecting citizens against fraud, money laundering and terrorism-financing activities.

What are Fintechs?

Fintech is a broadly used term, but for the purposes of this article, fintech is used to generally describe companies that provide a product, service, or similar benefit/value to a consumer or business. Customers rely on the fintech's ability to safely and effectively facilitate the movement of money (generally from Point A, to a temporary point B, to a final point C). In other words, the fintech is moving money in order to meet its obligation to the customer. By doing so, it may be exposed to federal and/or state money transmissions regulations.

Examples for consumers and businesses include:

- lending, savings, investment
- bill payment and banking
- prepaid and credit card



Banking Operations

Technology companies are by nature able to innovate, reach a large target audience, and scale quickly. Financial technology companies are no different with one notable exception: the additional burden of successfully navigating the complex web of federal and state financial regulations.

And while banks are often not able to innovate, pivot and grow quickly, they are experts in financial regulation and compliance. This expertise is invaluable for fintechs to achieve success.

Fintech-Banking Partnerships

With a bank partner who understands this ecosystem, companies are able to leverage their regulatory expertise to ensure safe, sound and compliant business operations. Additionally, each bank will have variant partnership models and particular areas of expertise and comfort – so finding the right partner-fit is paramount. The result is increased consumer and investor confidence in the company's long-term prospects.

A Tailored Solution: Master Disbursement, or “FBO” Services

Banks, by virtue of their structure and regulatory requirements, are exempt from individual state Money Transmitter License (MTL) requirements. Custodial accounts that are “for-the-benefit-of” certain third-party customers have been utilized for years, with trusts and escrow accounts being the most common traditional use.

These accounts are managed by third-party service providers, who hold funds for their customers as part of their trust or escrow service. FinCEN has ruled that this type of arrangement can be exempt from MTL. Therefore, there is potential for a fintech to utilize this account structure to process payment transactions on behalf of its customers. The bank owns the account (EIN) that holds the fintech's customer's funds, limiting regulatory risk.

In the use-case of ACH as a money movement method, payment instructions are provided to the bank from the fintech, as instructed by the individual consumer or business customers.

Utilizing the FBO account structure has the effect of removing the fintech from dominion over, or access to, client funds therefore, reducing exposure to money transmission regulations.

Benefits & Requirements of the FBO Account Structure

Given the heightened risk and compliance requirements, banks are hesitant to enter such arrangements with third-party providers (fintechs). And even those that do may find that their internal policies, processes and controls are not adequate for such arrangements. For example, banks must

have dedicated resources for fraud, BSA/AML, Consumer Compliance, Accounting & Finance to safely manage these programs. A failure in any of these areas can have significant consequences for all parties involved. Finding the right bank partner is key.

A partner that understands the market and the operational (and creative) requirements needed for a successful relationship. Similarly, banks must ensure that their fintech partners understand the importance of risk/compliance and can demonstrate proper controls.

BENEFITS:

- Customer Confidence: funds are held by a federally regulated financial institution that provides FDIC Insurance for all account holders within the aggregated account structure

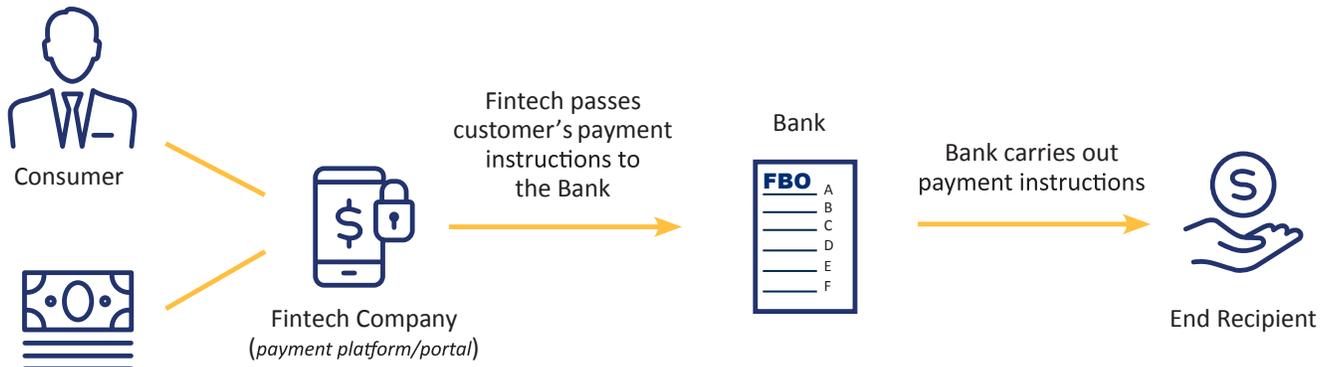
- Investor Confidence: proper risk management and controls resulting from bank oversight and ongoing monitoring
- Increased Control and Reduced Cost: Direct access to bank partner versus an intermediary

REQUIREMENTS:

- Dedicated Compliance Resources: proper KYC, BSA/AML and OFAC* compliance policies and oversight
- Ongoing Monitoring and Training: fraud tools and employee awareness
- 3rd Party Audits: bank may require certain types of external audits, an additional cost consideration

*Know Your Customer, Bank Secrecy Act, Anti Money Laundering, Office of Foreign Asset Control

Sample Funds Flow - FBO Structure



Compliance monitoring is occurring throughout the process.

Nacha recognizes SouthState for ACH payment volume



For more information about SouthState's banking options, please visit SouthStateBank.com/fintech

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