FedFin Client Report

Tuesday, September 12, 2017

What Bank Regulators Can Do Now About Equifax -- And to Whom

Client Report: **VENDOR7**

Executive Summary

In all the coverage of Equifax's cataclysmic cyber-breach, much has been said about the relatively unregulated nature of credit bureaus and the extent to which the FTC and/or CFPB could fill this void. In this report, clients are advised that the Bank Service Company Act has been successfully read by the federal agencies as covering any third-party vendor with which an insured depository has as little as a contractual relationship. When a regulator chooses to apply the terms of this Act to such relationships, the third party is subject to regulation and examination as if it were a bank. Clearly, this power if exercised would quickly bring credit bureaus under the ambit of tough cybersecurity rules without the need for statutory intervention. Although of little retroactive value now in ameliorating the cost to banks of fraudulent credit and frightened customers, this statutory authority could prove formidable going forward. In addition, the banking agencies may be questioned by Congress about the extent to which they used this authority to contain contagion risk from the bureaus, with banks also put on the spot by their examiners for requirements that have been in place since at least 2001 (although rarely applied or enforced until recent fintech transactions raised alarms). Given the scope of pending class-action litigation, any broader understanding of the third-party vendor standards could also expose banks to litigation risk. Although most banks have long sought to have third-party tech companies, retailers, and similar customers covered by stiff cyber standards, the industry has generally been reluctant to impose them through this contractual avenue out of concern about lost business. The need for services such as those provided by Equifax also limited the ability of banks to make demands. Now, we would expect this relationship to change dramatically at the behest of banks, their regulators, and the Congress.

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Analysis

Bank-regulatory interest in third-party vendors waxes and wanes with the sins these vendors are seen to commit. The regulatory framework was codified first with respect to the OCC's ability to charge examination fees in this case (see FSM Report **VENDOR4**), with other files in FedFin's **VENDOR** series covering inter-agency guidance, FFIEC standards, and FDIC requirements in this arena. Most recently, the Treasury Department under President Obama recommended that the banking agencies consider their service-company authority to govern online-marketplace lenders working with insured depositories (see FSM Report **FINTECH2**) and the OCC and FDIC acted on this to tighten their standards for third-party vendors in June of this year.

Although we do not here provide legal advice, the statutory language of the Bank Service Company Act (BSCA) is quite broad. Although intended principally to reach to companies established by an insured depository or group of them to reach outside the scope of bank supervision, the law and subsequent regulatory standards also cover services "caused" by a bank or bank affiliate through contract or "otherwise" for "services" not specified by the law. The 2017 OCC standards make it clear that services covered by its authority from third parties include:

- outsourced products and services;
- use of outside consultants;
- networking arrangements;
- merchant payment-processing services;
- services provided by subsidiaries and affiliates; and
- joint ventures and other business arrangements in which a bank has responsibilities and record-keeping obligations.

The OCC guidance goes on to stipulate what a national bank must do when the BSCA applies. In brief, a lot with regard to risk management, governance, and documentation. However, reflecting the new focus on tailoring and burden-relief, the OCC guidance also says that some third-party relationships present lower risks and, when management determines this, less governance is required. We do not expect the OCC or any other federal agency to determine that a relationship with Equifax or the other credit bureaus is a "lower-risk" one in light of the recent breach.

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