Treasury Fintech Report Recommendations Could Change Banking As We Know It

By Jane C. Luxton, Joann Needleman, Thomas A. Brooks / Aug 01, 2018

On February 3, 2017, President Trump issued Executive Order 13772 (“EO”), stating that “It shall be the policy of my Administration to regulate the United States financial system in a manner consistent with the following principles of regulation, which shall be known as the Core Principles.” The EO directed the Treasury Secretary to report to the President with regard to the extent existing laws, regulations, guidance, and other government policies promote those Core Principles. As mandated in the EO, Treasury issued the fourth and final report titled, “A Financial System That Creates Economic Opportunities Nonbank Financials, Fintech, and Innovation” (“Report”) on Tuesday, July 30, 2018. This Report, and its recommendations if implemented, will markedly change the way banking will be done in the United States.

In the Report, Treasury makes four recommendations which are designed to 1) streamline the regulatory environment to foster innovation across business models; 2) modernize activity specific regulations; 3) facilitate experimentation; and 4) embrace the efficient and responsible use of consumer financial data and competitive technologies.

Regulatory Consistency and Uniformity to Foster Innovation Across Business Models

The Report rightfully notes that “Nonbank financial service providers generally operate within a largely state-based regulatory regime requiring compliance with a disparate set of standards across individual states and territories that can be cumbersome and produce conflicting guidance for entities operating on a national basis.” For a fintech entity to operate in all state jurisdictions, the costs can be prohibitive, with upfront costs ranging from $1 million to $30 million. The Report finds that “In addition to these up-front costs, nonbank firms must actively monitor regulatory requirements across all the states in which they operate, pay fees to the applicable state regulators, and deploy significant resources to accommodate multiple state examinations, which can result in as many as 30 different state regulators per year examining a firm.”

To foster consistency and uniformity, the Report recommends:

- Advancing the harmonization of state licensing and supervision to increase efficiency, particularly for lending and payments companies.
- Moving forward with the Office of the Comptroller of the Currency's special purpose national bank charter to provide a federal approach to reducing regulatory fragmentation and supporting beneficial business models.
- Harmonizing guidance related to bank partnerships with third parties to improve efficiency and further enable technological innovation in a prudent manner.
- Improving the ability of banks to make innovation-related investments and flexibly adapt to new technologies by considering changes to applicable banking regulations.

Modernize Activity-Specific Regulations

The U.S. regulatory framework for key financial services requires meaningful modifications to improve the delivery of both digital and non-digital financial services to consumers and businesses. Such changes are aimed at improving the U.S. regulatory approach in areas such as lending, payments, and financial planning.

From a lending perspective, some of the recommendations in the Report include several changes to be made through regulation and legislation:

- Marketplace Lending: Congress should codify “the ‘valid when made‘ doctrine and the role of the bank as the ’true lender‘ of loans it makes to better support productive partnerships between banks and newer technology-based firms.” This would give purchasers of loans the assurance that the terms and conditions between a bank and borrower remain with the purchaser of the loan, clarifying some judicial confusion on this issue.
- Short-Term, Small-Dollar Installment Lending: Recognizing and supporting the authority of states to establish comprehensive requirements for these products and recommending that the Bureau of Consumer Financial Protection rescind its Payday Rule. Treasury also recommends that regulators take steps to encourage sustainable and responsible short-term, small-dollar installment lending by banks. The OCC already has made this decision regarding deposit advance products, but the FDIC has not proposed this activity.
- Debt Collection: Establishing minimum federal standards governing the collection of debt by third-party debt collectors.
- New Credit Models and Data: Further enabling the testing of newer credit models and data sources by both banks and nonbank financial companies to expand access to credit and improve risk assessments.
- Credit Bureaus: Coordinating regulatory actions by the relevant agencies to best protect consumer data held by credit reporting agencies.

From a payments perspective, the Report recommends that:

- State authorities should be encouraged to further harmonize licensing requirements and supervisory examinations, particularly for money transmission activities. Some states already have started this process through interstate compacts.
- The Federal Reserve should continue to modernize payment services by continuing to work to facilitate a faster retail payments system. In particular, smaller financial institutions, like community banks and credit unions, should also have the ability to access the most innovative technologies and

payment services.

From a wealth management and digital financial planning perspective, the Report recommends:

- Coordinate the current patchwork of regulatory authority over wealth management and financial planning, which makes these services more costly and potentially presents unnecessary barriers to the development of digital financial planning services.

Facilitate Experimentation

The Report declares that the “United States must preserve its leading position in financial innovation and must engage in agile and effective regulation for a 21st-century economy. If the United States does not take measures to enable innovative financial products and services, it risks losing out by failing to provide regulatory clarity and remove unnecessary barriers to innovation.” The Report recommends:

- Working with federal and state regulators to establish a system similar to a “regulatory sandbox” to invite innovations from new and existing market participants. The Bureau of Consumer Financial Protection is moving forward on its efforts in this regard, the OCC has invited applications for its new Special Purpose National Bank charter, and Arizona has passed legislation creating its own “sandbox.”
- Reform procurement rules and encourage regulator engagement to allow financial regulators to keep up with the technological developments of the industries they regulate
- Strengthening regulator engagement efforts with industry and the establishment of clear points of contact for industry and consumer outreach.
- Promoting the alignment of actions of international organizations with U.S. national interests and the domestic priorities of U.S. regulatory authorities.

Embrace the Efficient and Responsible use of Consumer Financial Data and Competitive Technologies

Developments in technology, cloud computing, and artificial intelligence have increased the magnitude and use of personal financial data available to consumers and businesses, raising important questions regarding data access, security, and liability. The Report recommends:

- Modernizing rules for digital communications, such as the Telephone Consumer Protection Act and the Fair Debt Collection Practices Act.
- Improving consumers’ access to their financial data by removing legal and regulatory uncertainties currently holding back the implementation of more secure and efficient methods of data access, providing disclosures written in plain language that enable consumers to give informed and affirmative consent regarding access to their financial account and transaction data, and giving consumers effective means to readily revoke prior authorizations.
- Strengthening the protection of consumer financial data through enacting a federal data security and breach notification law that is technology-neutral and is scalable to the type of activity and entity, and also recognizes existing federal data security requirements for financial institutions.
- Encouraging work on digital identity by enhancing public-private partnerships that facilitate the adoption of trustworthy digital legal identity products and services, and supporting efforts to fully implement the U.S. government federated digital identity system.
- Modernizing regulatory requirements and guidance for technologies like cloud computing, artificial intelligence, and machine learning in the financial services sector.

The recommendations made throughout the Report are timely and bold. In recent years, the delivery of financial services to consumers and businesses has been significantly impacted by the development of technology to improve the costs of products and services. While innovations abound, regulators’ primary concerns are the protection of depository institutions, their depositors, and their customers. A “slow approach” to regulating innovation within both the banking and non-bank industries usually is the result until the regulator can understand the risks associated with a new product or service. In turn, many in the financial services industry have been slow to adopt new technologies due to the risk exposure and lack of clear guidance by some regulators who have been too focused on enforcement to define best practices.

The United States is known for its dual banking system-a regime of federal laws and state laws. The proposals and recommendations in the Report will narrow the differences that exist between state and federal regulators’ application of these laws. Greater uniformity in the application of laws and regulations will result in a clearer understanding by the banking industry, as well as the entire financial services industry, as to its regulatory expectations, promote consistency in enforcement and ultimately provide greater consumer protections. While this has been the desire of all stakeholders, it has not always been the reality in the financial services regulatory world.

This Report suggests that moving forward, the philosophy will be different with banks and non-banks now operating on the same level playing field. Implementation of the recommendations in the Report will result in significant change. While some legislation might be needed, most of the change will occur at the regulatory level. It is critical that financial entities, whether they are traditional lenders or fintech innovators, have input in how the Report’s recommendations are implemented. Outreach to regulators will be critical and necessary in order to ensure that the goals of the report are met.

If you would like more information about the Report or how you might be impacted by its proposals, please contact Tommy Brooks, Joann Needleman or Jane Luxton.

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