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National Association of Federally-Insured Credit Unions

March 24, 2021

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

The Honorable Frank Pallone
Chairman
Committee on Energy & Commerce
United States House of Representatives
Washington, D.C. 20515

The Honorable Cathy McMorris Rodgers
Ranking Member
Committee on Energy & Commerce
United States House of Representatives
Washington, D.C. 20515

Re: Oversight and Regulation of Fintech and Technology Companies Operating in the Financial Services Space

Dear Chairwoman Waters, Chairman Pallone, Ranking Member McHenry, and Ranking Member McMorris Rodgers:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to share our comments on the growing issue of fintech—a term that covers the convergence of financial services and technology and the delivery of financial service products through emerging technologies and technology firms. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 124 million consumers with personal and small business financial service products. As your Committees examine the growing role that technology companies play in today's society, we urge you to examine their presence in the market for consumer financial services and the risks they pose to consumers and the financial system.

The growth of fintech in recent years offers new opportunities for the delivery of financial services. The use of financial technology can have a positive effect on credit union members. Credit unions have worked with fintech companies to improve efficiency in traditional banking, and many of the technologies that are commonplace today, such as credit cards and e-sign, would have once qualified as "fintech" when they were first introduced. Consumers today come to expect technological developments from their financial institution—from online banking to mobile bill pay. Many credit unions embrace innovations in technology to improve relationships with members and offer more convenient and faster access to financial products and services.

However, the growth of fintech can also present new threats and challenges as novel entities emerge in an underregulated environment. As such, NAFCU believes that Congress and regulators must ensure that when technology firms and fintechs compete with regulated financial institutions, they do so on a level playing field where smart regulations and consumer protections apply to all

participants. NAFCU has outlined some of the challenges and opportunities in this area in a [white paper](#) which proposes regulatory recommendations for oversight of fintech companies.¹

For example, fintech companies that specialize in lending, payments, or data aggregation present unique consumer protection concerns. A fintech company that permits consumers to consolidate control over multiple accounts on a single platform elevates the risk of fraud and may not be subject to regular cybersecurity examination and data privacy and protection requirements in the same way that credit unions are under the *Gramm-Leach-Bliley Act*. Although non-bank lenders are subject to consumer protection rules, the connectivity and segregation of discrete services within the fintech marketplace can create supervisory challenges.

Additionally, consumers may not be aware that funds deposited with certain fintech companies are not insured the same way deposits at a credit union or bank are and could be subject to loss. This could cause consumer confusion, or even harm confidence in the financial system should one of these companies have issues that cause a loss of consumer funds. An example of a step Congress could take to help ensure a level playing field would be to require a clear, concise, and prominent disclosure to consumers when funds are uninsured.

Financial Regulators Should Exercise Greater Oversight and Coordination to Supervise Fintechs

NAFCU believes financial regulators have a role to play in the supervision and regulation of fintechs under their existing authorities. Congress should also be willing to step in and clarify the role of regulators when necessary. For example, NAFCU believes that the Consumer Financial Protection Bureau (CFPB) can utilize its “larger participant” authority under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) to regulate and supervise technology firms and fintech companies that enjoy access to the financial services marketplace without the same supervisory expectations that apply to banks and credit unions. If the CFPB determines that supervision of fintech companies cannot be accomplished through its “larger participant” authority under the Dodd-Frank Act, then Congress should consider granting the Bureau explicit authority to supervise and examine fintech companies.

Congress should also consider creating a Federal Financial Institutions Examination Council (FFIEC) subcommittee on emerging technology (the subcommittee) to monitor the risks posed by fintech companies and develop a joint approach for facilitating responsible innovation.

We would envision the subcommittee having the following under its charge:

- a. Report its findings to Congress annually;
- b. define the parameters of responsible innovation to ensure consistent examination of emerging technologies;
- c. identify best practices for responsible innovation; and,
- d. recommend regulatory improvements to allow FFIEC-regulated institutions to adopt new technologies with greater legal certainty.

¹ NAFCU, Regulatory Approaches to Financial Technology, available at <https://www.nafcu.org/fintech-whitepaper>.

Technology Companies Pursuing Financial Charters

Recently, fintech companies are enjoying unprecedented liberalization of bank chartering rules to either acquire or become banks. Recent developments with both the Office of the Comptroller of the Currency's (OCC) new chartering options and the Federal Deposit Insurance Corporation's (FDIC) approval of deposit insurance for Industrial Loan Company (ILC) applicants also present problems. In each case, a nonbank company can potentially evade regulation under the *Bank Holding Company Act* (BHCA), either because of a statutory loophole unique to ILCs, or because the entity does not accept deposits. Lack of BHCA coverage raises serious concerns regarding the quality and extent of supervision for these specialized or limited purpose banking entities. Chartering additional ILCs or granting new licenses to payments companies could also weaken the safety and soundness of the wider financial system.

In certain cases, specialized, limited purpose bank charters may allow a fintech to operate with national bank privileges but without the same prudential safeguards that apply to traditional banks and credit unions. While some may characterize these chartering schemes as innovative, they are ultimately loopholes which invite unnecessary risk into the financial system and create an uneven playing field.

Special Purpose Fintech Charter

The emergence of new, fintech-powered business models has accelerated the disaggregation of bank services. This has not only increased competitive pressure but also challenged depository-centric models of financial supervision. The diversity of fintech companies and their role in the broader financial sector may necessitate reconsideration of existing models of regulation in the long run; however, an immediate focus for regulators and Congress must be to ensure that fintech companies are operating on a level playing field, and that new chartering options are presented transparently by banking regulators through full notice and comment rulemaking procedures. Furthermore, a level playing field encompasses more than just consistent application of federal consumer financial law. The appropriate application of prudential and supervisory expectations is an equally important consideration.

Research suggests that fintech mortgage lenders may enjoy structural advantages as nonbanks; in essence, benefiting from reduced regulatory burden which corresponds with relaxed federal safety and soundness standards. One report presented at the FDIC's April 2019 Fintech Symposium posited that 60 to 70 percent of "shadow bank" (i.e., nonbank lender) growth is likely due to regulatory arbitrage, and the rest due to advances in technology.² Other fintech companies may be enjoying reduced supervisory oversight even if they are subject to federal consumer financial law.

NAFCU recognizes that innovation depends on a fair, but flexible, regulatory regime for financial technology. Many credit unions partner with fintech companies to improve member service and historically these partnerships have proven invaluable to the growth and competitiveness of our

² See Piskorski, Tomasz, *Fintech and Shadow Banking* (April 2019), available at <https://www.fdic.gov/bank/analytical/fintech/presentations/piskorski.pdf>.

industry. Accordingly, NAFCU has advocated for expanding opportunities for credit unions to access pilot programs or regulatory sandboxes to test new products or services. At the same time, we have cautioned that frameworks designed to encourage innovation must not favor certain market participants at the expense of others.

When the OCC first introduced its general plan for a special purpose charter for fintech companies, NAFCU recommended that the OCC retain the core features of a national bank charter; namely, capital and liquidity requirements. Our position then assumed what we believe now, which is that the recipient of a specialized charter must be supervised as if it were a *bank*. The OCC's fintech charter should not serve as an occasion to offload traditional banking activities in exchange for comparatively lighter regulatory treatment.

In order to maintain safety and soundness within the broader financial sector, Congress should ensure that a fintech charter recipient is supervised as if it were a bank, regardless of whether its particular business model places greater emphasis on services other than deposit-taking or lending. Congress should also clarify that any special purpose fintech charter that confers the benefits of national preemption, or other privileges that have traditionally supported banks' deposit taking and lending roles, is bound by the same capital, liquidity, and consumer protection rules applicable to traditional banks and credit unions.

Payments Charter

In 2020, the OCC bypassed normal notice and comment rulemaking procedures to invite payments companies to apply for a limited purpose "payments charter." The payments charter has since drawn significant criticism from banks and credit unions alike and has inspired new litigation based on its core premise: that an entity choosing not to accept deposits can obtain the same privileges as a national bank.

One significant risk associated with the payments charter is the potential for reduced supervision of the bank applicant's holding company. By not accepting deposits, a payments charter recipient might not be regarded as BHCA bank, and its parent could avoid consolidated federal supervision by the Federal Reserve. Depending on the scale or risk of the holding company's activities—which might involve facilitating cryptocurrency transactions or issuing stablecoins per recent OCC guidance—lack of comprehensive Federal Reserve oversight could create additional risks for the American taxpayer if a specialized charter recipient fails because of weaknesses deriving from its parent's activities. Furthermore, the potential for a payments charter recipient to apply for master account access at the Federal Reserve could compromise the stability of our nation's payments systems. A payments charter recipient that does not accept deposits will not be clearly bound to the same capital and liquidity standards applicable to banks that receive federal deposit insurance. Easing or "tailoring" these important standards for entities that might access Federal Reserve payments systems could create new risks for our nation's financial infrastructure.

The OCC's payments charter has been marketed as one way to bring payments companies within the supervisory fold, an idea premised on the assumption that payments companies are willing to subject themselves to OCC supervision in exchange for certain privileges. While preventing

“leakage” of financial services activities into unregulated areas is a commendable goal, the reality of a specialized payments charter may be the same as with the OCC’s general fintech charter; namely, an occasion for fintech companies to engage in regulatory arbitrage.

We believe that Congress must ensure that payments charter recipients do not take advantage of the BHCA loophole and are subject to the same capital safety and soundness standards applicable to FDIC-insured banks.

Industrial Loan Companies

An ILC charter can offer certain nonbank parent companies the opportunity to skirt registration as a bank holding company and avoid consolidated supervision by the Federal Reserve.³ This reduced oversight is further exacerbated by the fact that the FDIC lacks a complete range of statutory authority to fully supervise certain parent companies of ILCs.⁴ As a result, the relationship between a nonbank parent and its ILC subsidiary lacks the degree of transparency and accountability intended by the BHCA while at the same time inviting potentially hazardous comingling of banking and commercial activities. In other words, the ILC charter frustrates a core principle of prudential regulation: that a bank’s parent company should serve as a transparent source of strength rather than an opaque source of risk.

NAFCU believes that the FDIC approving new ILC deposit insurance applications at this time could severely weaken the stability of the financial system, and we have urged the FDIC to suspend further chartering activity for at least three years so that a fully informed analysis of supervisory risks can be conducted. Furthermore, given technology companies’ interest in acquiring banks, the FDIC should also take heed of the unique privacy risks that might exist should consumer financial records find their way into the hands of nonbank parent companies through affiliate data sharing arrangements. A moratorium would also give Congress appropriate time to consider whether the ILC charter is conducive to advancing the goals of financial inclusion given the nonbank parent’s limited accountability to its banking subsidiary.⁵

The FDIC should be focused on helping ordinary consumers instead of devoting analytical and legal resources towards advancing the financial ambitions of technology giants. To that end, we believe Congress must take decisive action to stop chartering of new ILCs, eliminate the BHCA loophole for current ILCs, and solidify a core principle of banking regulation: that a bank’s parent company should serve as a transparent source of strength rather than an opaque source of risk.

³ Cocheo, Steve, “Fintech Charters Signal a Tectonic Realignment in Banking,” July 22, 2020.

⁴ Under Section 10(b)(4) of the FDI Act, the FDIC is permitted to examine any insured depository institution, including an ILC, to examine the affairs of any affiliate, including the parent holding company, “as may be necessary to disclose fully (i) the relationship between the institution and the affiliate; and (ii) to determine the effect of such relationship on the depository institution.” 12 U.S.C. § 1820(b)(4). However, this limited grant of authority is no substitute for the full range of examination powers necessary for consolidated supervision.

⁵ In contrast to BHCA banks, a non-BHC parent company would not be prohibited from commencing “new activities” if a subsidiary depository institution has a CRA rating that falls below satisfactory. *See* 12 CFR § 225.84.

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National Trust Banks

Recently, the OCC issued novel interpretations of its rules for national trust charters, without soliciting public input through normal rulemaking procedures.⁶ In essence, the OCC has paved the way for banks to engage in a novel type of fiduciary activity: cryptocurrency custodial services. The OCC has also taken the position that a permissible fiduciary activity for a national trust bank is any activity that state law permits for a state trust company which comes into competition with a national bank. Previously, the OCC had taken the more prudent approach of first examining whether the proposed fiduciary activity was in fact ‘fiduciary’ within the meaning of 12 U.S.C. § 92a.⁷ The practical consequence of this new interpretation is to relax standards for conversions of state trust companies into non-depository, national trust banks. Already the consequences of this arrangement are apparent—the OCC has already received applications from state trust companies that are heavily engaged in digital asset-related activities. While there may be a role for this, we believe Congress should not allow the OCC to promulgate new chartering standards for trust banks through legal interpretations that bypass normal notice and comment rulemaking processes.

Conclusion

In conclusion, credit unions look forward to continuing to experience growth in the technology space as a way for them to better serve their members. However, as technology companies expand, and new companies emerge, to compete in the financial services area, it is important that they compete on a level playing field of federal regulation—from data privacy and security to consumer protection. Finally, it is important that Congress ensures laws are modernized to allow regulated financial institutions, such as credit unions, to keep up and compete with technological advances.

NAFCU appreciates your attention to these important issues. Should you have any questions or require additional information, please do not hesitate to contact me or Sarah Jacobs, NAFCU’s Associate Director of Legislative Affairs, at (571) 289-7550 or sjacobs@nafcu.org.

Sincerely,



Brad Thaler
Vice President of Legislative Affairs

cc: Members of the Committee on Financial Services
Members of the Committee on Energy and Commerce

⁶ OCC, Interpretive Letter #1176 (January 2021), available at <https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1176.pdf>.

⁷ *See id.* at 4, fn. 5.