NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

May 31, 2022

Comment Intake—Supervisory Authority Over
Certain Nonbank Covered Persons Based on Risk
Determination; Public Release of Decisions and Orders
1700 G Street NW
Washington, DC 20552

RE: Request for Comment Regarding Procedural Rule on Supervisory Authority Over Certain Nonbank Covered Persons Based on Risk Determination; Public Release of Decisions and Orders (Docket No. CFPB-2022-0024)

Dear Sir or Madam:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the request for comment (RFC) issued by the Consumer Financial Protection Bureau (CFPB or Bureau) regarding its proposed procedural rule on the Bureau's supervisory authority over certain nonbank covered persons based on a risk determination and the related public release of decisions and orders. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 130 million consumers with personal and small business financial service products. NAFCU appreciates the Bureau's efforts to provide transparency and to level the playing field in the consumer finance market. NAFCU supports the Bureau's decision to begin exercising its "dormant authority" to supervise nonbank entities that it has determined pose a risk to consumers. NAFCU also supports the Bureau's proposal to make final decisions and orders from its supervisory activities public to increase transparency in the Bureau's actions and provide a larger body of precedent for credit unions to rely upon. However, the Bureau can and should do more to regularly supervise these underregulated market players, including exercising its "larger participant" authority.

General Comments

On April 25, 2022, the Bureau announced that it would begin exercising its "dormant authority" under Section 1024(a)(1)(C) of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (Dodd-Frank) to supervise nonbank entities—including financial technology or "fintech" firms—that it has determined pose a risk to consumers. On April 29, 2022, the Bureau also published a procedural rule to amend an aspect of its procedures for establishing supervisory authority over a covered person based on a risk determination. Specifically, the rule would add a mechanism for the Bureau to make final decisions and orders in supervisory proceedings public.

Although the supervisory authority under Section 1024(a)(1)(C) and the proposed procedural rule would have broad applicability to nonbank covered persons, the majority of nonbank persons engaged in the provision of consumer financial products and services could accurately be categorized as fintech companies, that is, non-chartered, nonbank institutions that reach consumers through digital channels. For many years, credit unions have partnered with fintech companies to improve operations, deliver new products and services, and enhance member experiences. NAFCU advocates for a regulatory environment that promotes competition and responsible innovation; however, the risk of regulatory arbitrage remains a concern as fintech companies continue to operate on the periphery of traditional supervisory domains.

In order to exist outside the purview of a prudential regulator, and thereby avoid the costs associated with regulatory supervision, many fintechs choose to specialize and offer a limited selection of specific products rather than the full suite of financial services. Although increasingly tech savvy young consumers may prefer this "a la carte" style banking, with a different financial institution for each financial product, this situation could result in one consumer with multiple banking relationships with multiple companies, such that only the core deposit relationship is subject to regular supervision and examination for safety and soundness. Disaggregation of payments, lending, and deposit-taking activities without a corresponding update to the Bureau's supervisory framework for nonbank fintechs could expose consumers to greater risk by making it more difficult to prevent violations of consumer financial law before they occur. Furthermore, financial companies outside the Bureau's supervisory jurisdiction may not feel the same obligation as covered persons to invest in high-touch compliance programs. NAFCU has observed, for example, that members prefer contacting their credit union when they have problems with third party payment services, such as an unauthorized peer-to-peer (P2P) transfer, despite the credit union having minimal connection to the underlying transaction on the third party's platform.

Risks of Fintechs

The rapid evolution of fintechs and their bias for experimentation has presented credit unions and their members with numerous opportunities for innovation as well as significant areas of concern. To remain competitive and relevant in today's financial marketplace, many credit unions are considering whether to invest in new technologies or partner with fintech companies. At the same time, credit unions must grapple with the reality that fintechs, as nonbanks, may have structural advantages, in essence benefiting from reduced regulatory burden that corresponds with a lack of federal safety and soundness standards. In announcing its intention to exercise its dormant authority over nonbank entities, and in publishing the amended rule to make final decisions and orders public, the Bureau is taking a first step in the right direction. In order to truly address and mitigate the risks posed by fintechs, the Bureau must go further and exercise its "larger participant" authority over these entities as well.

The growth of fintech market share and the adoption of fintech products and services by consumers has been explosive. In 2019, 64 percent of consumers worldwide had used one or more fintech platforms, up from 33 percent in 2017.[1] In terms of lending, nearly half of all personal loans in the U.S. are originated by fintechs, up from 22 percent in 2015, as estimated by the Consumer Bankers Association. The five leading providers of buy-now-pay-later (BNPL) installment loans, the subject of a recent Bureau inquiry, are all fintechs. Use of fintechs by consumers is even more prevalent for payments, with 71 percent of consumers indicating that they leverage the services of fintech companies such as PayPal or Venmo for payments.[2] Without question, fintechs have become major players in the consumer finance market and could easily be categorized as "larger participants."

NAFCU encourages all relevant regulators to ensure that when fintechs compete with traditional financial institutions, they do so on a level playing field where smart regulations and consumer protections apply to all actors in the consumer marketplace. Regulations and laws have evolved in a piecemeal fashion as both traditional and non-traditional financial institutions transition to a world of faster payments, alternative data, and machine learning. While most fintech products and services already fit within the existing scope of federal consumer financial law, which addresses the core banking activities of lending, payments, and deposit-taking, significant supervisory gaps exist that fail to address certain fintech business models—particularly those that raise consumer compliance risks. Nonbank lenders are not subject to the same safety and soundness regulations as banks and credit unions. This disparity poses serious, systemic risks given the growing market share that these firms represent and could have carry-on effects that impact consumers directly. For example, some consumers have recently been harmed by the collapse of the Terra stablecoin and its Luna token and have been forced to rely on the prudence of cryptocurrency exchanges to delist the stablecoin and protect them from further losses.[3]

In the lending space, fintechs, displaying their capacity to adapt, have begun to offer financial products and services such as BNPL that fall outside the scope of some consumer protection laws. The failure of the firms offering these products to adhere to consumer protection laws and traditional financial institution norms raises concerns over data protection, lack of disclosures, and dispute resolution protections as well as late fees and policies that expose consumers to greater risk of financial harm. More specifically, the absence of standardized disclosures in BNPL fintech lending combined with misleading marketing creates concerning potential for hidden fees and expenses. Firms that offer these types of products would seem to be engaging in the exact type of conduct that poses risks to consumers described in Section 1024(a)(1)(C) and could benefit from supervision.

Concerns regarding data security and the accessibility of consumer financial data also warrant increased scrutiny. For example, many fintechs collect vast amounts of consumer data but are not subject to cybersecurity examinations in the same way that credit unions or other financial institutions are under the *Gramm–Leach–Bliley Act* (GLBA) and Regulation P. Consumer data

[1] *See* Ernst & Young, "Global FinTech Adoption Index 2019" *available at* https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/banking-and-capital-markets/ey-global-fintech-adoption-index.pdf.
[2] *See* MX Technologies, "COVID-19's Impact on the Fintech Landscape" *available at* https://www.mx.com/infographics/fintech-landscape-amid-covid-19/.
[3] *See* Wall Street Journal, "Luna Wasn't on Terra Firma" *available at* https://www.wsj.com/articles/this-stablecoin-wasnt-on-terra-firma-11652373663?mod=business_minor_pos12.

collected by these companies may go far beyond Social Security numbers or transactional information—it might also contain behavioral indicators that could greatly magnify the risk of social engineering attacks on individual consumers.

In the context of payments and Regulation E error resolution, NAFCU has advocated for more equitable mechanisms for allocating error resolution duties between traditional financial institutions such as credit unions and fintech payment providers. Specifically, NAFCU has urged the Bureau to clarify that in certain instances the P2P provider bears primary responsibility for investigating alleged payment errors. In situations where it is difficult for a financial institution to reasonably determine what funds were used in the unauthorized P2P transaction, the P2P provider will be in a better position to investigate and resolve the error. Consumers would benefit from such a clarification in instances when P2P providers are able to resolve disputes more accurately and with greater efficiency because they possess all of the relevant information for analyzing transactions on their own platform. As the ubiquity of P2P payments among consumers increases, so too do the risks associated with these products, and the Bureau should strongly consider exercising its "larger participant" authority over P2P payment providers to ensure adequate consumer protections and equitable allocation of error resolution responsibilities.

For traditional financial institutions such as credit unions, these risks are particularly troubling and have a real-world impact for credit unions that must deal with the fallout from their members being harmed by the insufficient regulatory framework for fintechs. The Bureau's exercise of its supervisory authority over fintechs that pose risks to consumers is a first step toward closing supervisory gaps and establishing a level playing field in the consumer finance market.

Benefits of Transparency

The exception to the confidentiality of final decisions and orders that would be created by Section 1091.115(c)(2) would also represent a beneficial movement toward transparency in the supervision of nonbank entities. This benefit would extend to all financial institutions by providing them with more clear examples of the types of acts and practices that pose risks to consumers. These disclosures would also benefit consumers by making supervisory decisions publicly available, therefore providing consumers with more information on which to base their choice as they shop for financial products and services.

As credit unions and other traditional financial institutions evolve with the times and begin to offer new products and services, the disclosure of decisions and orders from nonbank supervision would help to guide credit unions in the decision to adopt new models or enter new spaces. For example, the use of alternative data has attracted scrutiny as potentially problematic. The use of non-traditional indicators of borrower creditworthiness offers an avenue for improving access to credit for credit invisible consumers, and credit unions value opportunities to help their members build their credit and obtain the financial assistance they need. However, without further clarity, the use of such data may present fair lending risks. Similarly, the proliferation of BNPL, while attractive to consumers and financial institutions alike, can present risks of financial harm to consumers and may conflict with consumer protections laws and regulations.

As discussed in NAFCU's March 25, 2022, comment letter, BNPL, as offered in the pay-in-4 model, is a prime example of the type of financial product or service that is tailored to avoid application of certain federal and state laws. In the case of BNPL, credit that is repayable in more than four installments or includes a finance charge is subject to the federal *Truth in Lending Act*'s rules on consumer lending terms and disclosures found in Regulation Z. By offering BNPL in a pay-in-4 model, BNPL providers sidestep these rules and, as a result, disadvantage consumers using the products. Troublingly, in instances of regulatory or supervisory avoidance such as this, consumers are unlikely to be aware of the absence of these protections and will view these products or others as an equally safe alternative to traditional financial products and services.

Additionally, the formal rulemaking process used by federal financial regulators often lags behind the pace of technological evolution in the financial sector. As a result, the Bureau's approach to fintechs may exhibit the limitations of reactionary policy, failing to account for new products and services such as decentralized finance platforms offering products that evade easy regulatory classification.[4] The steady, consistent accumulation of a supervisory data covering the activities of nonbank entities through regular examination would better inform the market and better protect consumers.

Although confidentiality is important to the supervisory process, NAFCU believes that the *Freedom of Information Act* (FOIA) exemptions discussed by the Bureau would provide adequate protection for sensitive information reflected in final decisions and orders. Specifically, Exemption 4, which applies to "trade secrets and commercial or financial information obtained from a person and privileged or confidential," and Exemption 6, which applies to "personnel and medical files and similar files the disclosure of which would constitute a clearly unwarranted invasion of personal privacy," could reasonably apply to a wide variety of sensitive consumer information and would give nonbank entities that are subject to supervision ample means by which to limit the contents of a public supervisory order.

Conclusion

NAFCU appreciates the opportunity to provide comments on this RFC. NAFCU supports the Bureau's decision to exercise its authority over nonbank entities, to conduct examinations of fintech companies, and "to hold nonbanks to the same standards that banks are held to."[5] NAFCU also supports the proposed procedural rule that authorizes the Bureau to publish its decisions about whether certain nonbank entities present such a risk. Finally, as fintech proliferation in the consumer finance market continues, the Bureau should exercise its "larger participant" authority over entities such as P2P payment providers and certain fintech lenders. If we can answer any

[4] *See* President's Working Group Report on Stablecoins (November 2021) ("Despite some asserted distinctions from more traditional or centralized financial products, services, and activities, DeFi arrangements often offer the same or similar products, services, and activities, and raise similar investor and consumer protection, market integrity, and policy concerns.").
[5] *See* Consumer Financial Protection Bureau," CFPB Invokes Dormant Authority to Examine Nonbank Companies Posing Risks to Consumers" *available at* https://www.consumerfinance.gov/about-us/newsroom/cfpb-invokes-dormant-authority-to-examine-nonbank-companies-posing-risks-to-consumers/.

questions or provide you with additional information, please do not hesitate to contact me at 703-615-5109 or jakin@nafcu.org.

Sincerely,

James Akin
Regulatory Affairs Counsel