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National Association of Federally-Insured Credit Unions

September 28, 2020

The Honorable Stephen F. Lynch
Chairman
Task Force on Financial Technology
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

The Honorable Tom Emmer
Ranking Member
Task Force on Financial Technology
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Re: Tomorrow's Hearing, "License to Bank: Examining the Legal Framework Governing Who Can Lend and Process Payments in the Fintech Age"

Dear Chairman Lynch:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to share our comments related to tomorrow's hearing, "License to Bank: Examining the Legal Framework Governing Who Can Lend and Process Payments in the Fintech Age." NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 121 million consumers with personal and small business financial service products. NAFCU advocates for competitive equality between traditional financial institutions and fintech companies, which we generalize as nonbank institutions that reach consumers through digital channels. Both industrial loan company (ILC) charters and the Office of the Comptroller of the Currency's (OCC) payment charter frustrate the goal of establishing a level playing field by permitting recipients of either license to reduce the extent of federal supervision compared to traditional financial institutions.

At the supervisory level, both the OCC's special purpose payments charter and the existing ILC charter present the same problem. In each case, a nonbank company can 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 banking entities. Chartering additional ILCs or granting new licenses to nonbank payments companies could also weaken the safety and soundness of the wider financial system.

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 relative to traditional financial institutions,

including credit unions. NAFCU has defined this focus in terms of compliance with federal consumer financial law, but adequate supervision 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 Federal Deposit Insurance Corporation's (FDIC) 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.[1] 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 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 *bank*, even if its particular business model places greater emphasis on services other than deposit-taking or lending. In this regard, NAFCU remains skeptical of the OCC's assertion that it can offer a charter to a nonbank licensee which confers the benefits of national preemption, interest rate exportation, and other privileges that have traditionally supported banks' deposit taking and lending roles.

Payments Charter

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.

Companies that have the ability and desire to operate with fewer regulatory constraints will continue doing so until regulatory barriers are lowered, possibly to such an extent that there is no meaningful containment of risk. In the absence of legislative action, the OCC must entice new entrants to accept additional oversight—a balancing act that is hardly conducive to maintaining a safe and sound banking system.

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

The OCC's strategy for managing safety and soundness risks associated with its payments charter has also been obscured from public view. The Acting Comptroller introduced the payments charter informally, without notice and comment, and then determined—after hearing from a coalition of financial services trades that a transparent rulemaking should be preferred—that a discrete proposal was not required. [2]

NAFCU has also expressed concern with the OCC's view of traditional banking services. Public comments from the Acting Comptroller predict a future where institutions "that lack scale […] will find themselves under pressure to consider unbundling or spinning off various functions." NAFCU finds that this perspective overlooks the important benefits of a full-service banking model and, more significantly, presumes that smaller, community institutions will not be able to provide a full range of services in the future. NAFCU disagrees with this assertion, but if the OCC is interested in testing the validity of its assumptions then it should put its new licensing proposals out for public comment. In this regard, Congress should encourage the OCC to work with other Federal Financial Institutions Examination Council (FFIEC) member agencies, including the National Credit Union Administration (NCUA), if it intends to perpetuate specialized chartering options that could impact overall financial sector stability.

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 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

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[2] *See* Cocheo, Steve, "Fintech Charters Signal a Tectonic Realignment in Banking," July 22, 2020, available at https://thefinancialbrand.com/98636/occ-comptroller-brian-brooks-fintech-charter-payments-innovation-crypto-branch/. *See also* Guida, Victoria, " Top regulator pushes ahead with plan to reshape banking, sparking clash with states," August 31, 2020, available at https://www.politico.com/news/2020/08/31/currency-comptroller-reshape-banking-406393.
[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.

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]

Today, with the pandemic continuing to place unique strains on financial institutions and their customers, it would be prudent for Congress to support a moratorium on new ILCs. The FDIC should be focused on helping ordinary consumers instead of devoting analytical and legal resources towards advancing the financial ambitions of technology giants.[6]

Conclusion

NAFCU believes that regulators should not give preference to fintech as a *new* model of banking ready to replace traditional institutions, but rather seek to modernize traditional supervisory frameworks to ensure that the promise of better, more efficient service and expanded access to credit is predicated on responsible innovation rather than regulatory arbitrage. In addition, we believe that regulators should not seek to introduce specialized chartering options without a full and transparent rulemaking process that invites careful consideration of how recipients of fintech-specific charters might impact the safety and soundness of the financial sector.

We ask that Congress consider a moratorium on future consideration and approval of ILC deposit insurance applications for at least three years so that the banking regulators can devote appropriate resources to help facilitate the nation's economic recovery from the COVID-19 pandemic.

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 Task Force on Financial Technology

[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.
[6] Hrushka, Ann, "Rakuten to continue ILC charter pursuit, subsidiary CEO says" (August 26, 2020), available at https://www.bankingdive.com/news/rakuten-to-continue-ilc-charter-pursuit-subsidiary-ceo-says/584189/.