NAFCU'S LEGISLATIVE AND REGUALTORY FINTECH PRINCIPLES

As NAFCU has outlined in its whitepaper titled "Regulatory Approached to Financial Technology," there is a need for enhanced coordination between federal banking agencies to reduce the potential for fintech arbitrage in a fragmented regulatory environment. NAFCU has also advocated for (1) the Consumer Financial Protection Bureau (CFPB) to exercise its "larger participants" authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act to regulate and supervise fintech companies; and (2) the Office of the Comptroller of the Currency (OCC) to present fintech-friendly chartering options only after soliciting public input through transparent rulemaking procedures.

If regulators do not act quickly, Congress should step in to require a robust regulatory framework that balances consumer protection and prudential concerns with the goal of promoting responsible innovation within the financial marketplace. Congress should consider legislation that establishes the following:

1. Explicit authority for the CPFB to regulate all fintech companies not already overseen by a federal banking regulator.
2. Congress should require the OCC to present new chartering options (e.g., payments charters, fintech charters, or other limited purpose charters) through full notice and comment rulemakings.
3. 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 innovation.

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

FINTECH COMPANIES COULD GAME THE SYSTEM

The enhanced oversight described above is even more necessary now because fintech companies are enjoying unprecedented liberalization of bank chartering standards to either acquire or become banks. While some may characterize new limited purpose chartering schemes as innovative, they are ultimately loopholes which invite unnecessary risk into the financial system and create an uneven playing field.

Below, NAFCU outlines several examples of these chartering schemes as well as legislative recommendations to ensure a level playing field and protect consumers:

1. **Industrial Loan Companies (ILCs) – Federal Deposit Insurance Corporation (FDIC)**

Congress must take decisive action to end 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.

ILCs have proven attractive to fintech companies at a conceptual level because they can be owned by firms that are not subject to comprehensive federal oversight and are free to engage in commercial activities. Specifically, an entity that controls an ILC that is not a bank holding company under the Bank Holding Company Act (BHCA) does not need to register as a bank holding company with the Federal Reserve and avoids consolidated federal supervision.

Loopholes in federal law that permit nonbank firms to own ILCs have prompted criticism of the charter in high profile cases. In 2006, shortly after Wal-Mart applied to create a new ILC and Home Depot attempted to acquire an existing bank, the FDIC imposed a moratorium on new commercial charters. At the time, the FDIC expressed concern that commercial ownership of ILCs posed safety and soundness risks that were better left to Congress to resolve. While recent FDIC rules have attempted to mitigate the most obvious consequences of this loophole, they are not comparable to true oversight through consolidated federal supervision by the Federal Reserve.

2. **Payments Charter – OCC**

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. Congress must also require the OCC to propose its payments charter through a notice and comment rulemaking.

In late 2020, the OCC bypassed normal notice and comment rulemaking procedures to invite payments companies to apply for a limited purpose "payments charter." 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 holding company 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 make our nation's payments systems less resilient to liquidity risks.

3. **Fintech Charter – OCC**

To maintain safety and soundness within the broader financial sector, Congress should: (1) ensure that a fintech charter recipient is supervised as if it were bank, regardless of whether its particular business model places greater emphasis on services other than deposit-taking or lending; and (2) clarify that any special purpose 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.

When the OCC first introduced its general plan for a special purpose charter for fintech companies in late 2016, NAFCU recommended that the OCC retain the core features of a national bank charter; namely, capital and liquidity requirements. The OCC's fintech charter should not serve as an occasion to offload traditional banking activities in exchange for comparatively lighter regulatory treatment.

4. **National Trust Banks – OCC**

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.

Through Interpretive Letter #1176, the OCC promulgated new standards for trust bank chartering without soliciting public input through normal rulemaking procedures. The practical consequence of this new interpretation is to relax standards for conversions of state trust companies into non-depository, national trust banks by expanding the scope of permissible fiduciary activities. Prior to this interpretation, the OCC had taken the more prudent approach of first examining whether a proposed fiduciary activity was in fact 'fiduciary' within the meaning of 12 U.S.C. § 92a. State trust companies engaged in cryptocurrency-related activities (the subject of separate OCC guidance also issued without opportunity for public comment) could take advantage of new chartering standards to secure the benefits of national preemption and magnify the financial stability risks associated with digital assets.