Fintech: A State Regulator's Perspective
By Bryan A. Schneider

How do you define fintech?

- Is it back-office technology that supports normal business operations?
- Is it electronic money transmission or new types of currency?
- Is it a third-party service provider that can fulfill bank functions?
- Is it a new business model that disintermediates existing players?

The answer to all of these questions is "yes."

A definition so broad and all-encompassing presents a challenge: how are state financial regulators – those on the front lines of a wide range of financial services – supervising fintech?

At the Illinois Department of Financial and Professional Regulation, our regulatory approach has been to focus on business activity, not technology. To do the reverse would be like the tail wagging the dog.

In using this approach, we have found that most fintech firms can be placed in the context of existing law. For instance, if online companies are engaged in moving money from account A to account B – think PayPal – we apply money transmission laws. If other online companies are offering home loans – think Quicken Loans – we apply mortgage lending laws. And so on.

States routinely examine their toolkit – existing laws and regulations – and determine whether new tools are needed. For example, the state of North Carolina recently approved a virtual currency bill whereby permissible investments should be held in "like kind." In other words, rather than holding the present value of bitcoin in cash – a difficult currency transfer calculation – permissible investments can be held in bitcoin.

As regulators, we embrace technology to simplify the state licensing process. Financial firms can submit licensing information one time to multiple states through the Nationwide Multistate Licensing System, a form of "regtech" operated by the Conference of State Bank Supervisors. Consumers, in turn, can use the NMLS consumer access website to view the licensed entities and any regulatory actions against the firms.

All of this reflects the value of the state regulatory system: we experiment; we see what works; we replicate the model in other states; and then we standardize the model nationwide. The progression is always the same: as business models mature, so do regulatory regimes.

Lately, there is a lot of discussion on whether or not a regulatory regime for fintech should include a new federal business charter. Federal charters confer significant advantages, expectations and risks. Historically, these charters have been the exception, not the rule.

For instance, in the mid-1800s, Congress sought ways to raise money for the Civil War and unify the currency. So it created the Office of the Comptroller of the Currency, with authority to charter national banks. During the Great Depression, shoring up access to home loans became a national priority. So Congress created Federal Home Loan Banks to provide liquidity to savings-and-loan associations, and through the Federal Credit Union Act to charter credit unions. To supplement these local deposits with capital market funds, Congress chartered Fannie Mae and, decades later, Freddie Mac as a response to distress being experienced by S&Ls.

From this history, we see a few common elements of federal business charters:

- They are rare;
- They are created in times of national crisis;
- They are focused on stabilizing the financial system;
- They create special ties to the federal government and taxpayers; and
- In exchange for this risk, federal charters are designed to produce broad, public benefits.

A federal business charter for fintech does not fit in with this history. There is no national crisis. Stabilizing the financial system is not the driving force. And the public benefits of fintech do not appear to have the same impact and scale as unifying the U.S. currency, ensuring mortgage liquidity, and otherwise addressing the financial impacts of the Great Depression and S&L crisis.

Meanwhile, consumers will have to be protected. From a state perspective, we recall federal preemption of state consumer protection laws occurred in the early 2000s. The housing crisis followed, and millions of Americans ended up losing their homes in foreclosure. It took Congress to reset the state-federal balance to consumer protection regulation.

All this demonstrates why Congress should press fintech advocates on why a new federal business charter justifies a departure from historical traditions and lessons learned. Rather than addressing an economic crisis, a fintech charter would place the federal government in the business of choosing winners and losers within a marketplace, with the potential to distort, rather than strengthen, the banking system. Only Congress should determine chartering authority, as it has done in the past.

In the meantime, state regulators will continue to do our job. As chairman of the CSBS task force on emerging payments and innovation, I realize there is much to do. Our emphasis on safety and soundness and consumer protection should not stifle worthy business innovation. While the process of multi-state licensing has become more efficient, there’s still room for improvement. And more uniformity in state laws – if done right – would benefit everyone.

Key to these endeavors is having regular, open communication with the stakeholders involved in fintech. Their insights are essential to more effective regulation. And in a fast-moving environment, the more forums for information sharing we have, the better. This is the direction to which we are committed.

Bryan A. Schneider is secretary at Illinois Department of Financial and Professional Regulation.

A version of this column was published in American Banker, Oct. 19, 2016