CSBS

License to Bank: Who Lends and Processes Payments in the Fintech Age

Statements & Comments

STATEMENT FOR THE RECORD FROM THE
CONFERENCE OF STATE BANK SUPERVISORS TO THE
TASK FORCE ON FINANCIAL TECHNOLOGY OF THE
U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES HEARING ON
"LICENSE TO BANK: EXAMINING THE LEGAL FRAMEWORK GOVERNING WHO CAN LEND AND PROCESS PAYMENTS IN THE FINTECH AGE"
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I. Introduction

The Conference of State Bank Supervisors (CSBS) thanks the House Financial Services Task Force on Financial Technology for convening this important hearing entitled "License to Bank: Examining the Legal Framework Governing Who Can Lend and Process Payments in the Fintech Age." CSBS is the nationwide organization of banking regulators from all 50 states, the District of Columbia, Guam, Puerto Rico, American Samoa and the U.S. Virgin Islands. CSBS was established in 1902 to support and improve the dual banking system by bringing state banking regulators together and promoting state-federal regulatory coordination.

State regulators charter and supervise 79 percent of all U.S. banks and are the primary regulators of a diverse range of nonbank financial services providers, including mortgage lenders, money transmitters and consumer lenders. CSBS, on behalf of state regulators, also operates the Nationwide Multistate Licensing System (NMLS), a regulatory licensing platform for state-licensed nonbank financial services providers in the money services, mortgage, consumer finance and debt industries.

The United States benefits from a diverse array of bank and nonbank entities providing lending and payments services today. These companies operate in a regulated environment defined by federal and state laws, with state regulators performing robust, responsive and tailored oversight of each of these company types:

- State regulators oversee nonbank payments companies responsible for $1.4 trillion in annual payments activity, encompassing small brick-and-mortar companies to large, internationally active corporations moving billions of dollars.
- Similarly, state regulators license and supervise a wide variety of nonbank consumer lenders extending credit to borrowers all across the country.
- Finally, state regulators charter and supervise banking organizations that play an important role in facilitating payments and extending credit to consumers and businesses.

CSBS appreciates the opportunity to share how states regulate these companies, as well as how the state system encourages creativity, experimentation, diversity and choice, all of which enhance local economic development, market competition and business flexibility.

The U.S. economy and financial system do not suffer from a lack of innovation or an environment in which innovation is stifled. Indeed, the staggering variety of innovative companies, activities, products and services in the U.S. financial services space is unique among peer nations, and this is a direct result of our federalist financial regulatory system. Just like our federalist dual banking system fosters the most diverse and vibrant banking industry in the world – over 5,000 banks of all shapes and sizes – the state nonbank regulatory system has encouraged and facilitated unparalleled innovations in the payments, consumer lending, mortgage and debt industries. Financial services innovation, including in the payments and consumer lending space, is a key feature and result of our existing financial regulatory system.

Regulations and regulatory systems must certainly adapt to keep pace with the innovation already occurring in the U.S. financial services industry. The state regulatory system has proven that it promotes innovation, ensures market stability and protects consumers. State regulators believe our federalist regulatory framework should serve as the foundation and be reinforced through any potential regulatory changes.

This statement discusses state regulators' perspectives on ways the U.S. regulatory system can adapt to continue fostering innovation in the financial services system, particularly in the payments and consumer lending industries. In particular, this statement details:

- How state payments and consumer lending regulation encourages innovation and flexibility and protects consumers.
- How state regulators' Vision 2020 initiatives are improving payments and consumer lending regulation.
- How state regulators oversee payments and lending activities conducted by banks.
- Why the Office of the Comptroller of the Currency's efforts to charter fintech and payments firms is problematic.

II. State Regulation of Payments and Lending Activities

The state regulatory framework is a strong feature of our federalist system of government and financial regulation. Corporate formation and business regulation are the domain of state law, except in extremely limited circumstances. This principle has been reaffirmed by Congress and the U.S. Supreme Court time and time again.

Under our federalist construct, states are the primary regulator of nonbank companies that wish to engage in payments and consumer lending activities. State oversight of businesses engaged in payments and lending activities supports innovation and flexibility, while at the same time ensuring consumers are well protected.

State Regulation Encourages Financial Innovation & Business Flexibility

Generally, states require nonbank companies to obtain a license if they wish to offer financial services to residents within their state. These licensing laws are “activities-based,” as opposed to “entity-based,” and cover such financial activities as money transmission, consumer lending, mortgage lending and debt collection. Since state licensing laws are activities-based, they provide businesses with flexibility and appropriately scaled regulation. Companies engaging in certain, discrete financial activities are licensed and supervised according to their choice of activity and how it fits within their broader business model.

Many nonbank companies wish to engage almost exclusively in one (or several) of these state- licensed financial activities. For example, a money transmitter (licensed as a money services business, or MSB) facilitates transfers of funds between individuals, whether online or through an agent at a physical location. This money transmitter’s business is virtually all financial in nature. However, many other companies’ financial activities are incidental to their core business functions. For example, an online retailer may offer a payments service (again, licensed as an MSB) to expedite the checkout and payment process for its merchants and consumers. The retailer’s regulatory obligations are limited, just like its financial activities are limited, to state-licensed payments activities.

The state regulatory system accommodates a diverse array of companies seeking to enter the marketplace, including brand new startups and firms looking to scale their operations quickly. In 2019, 92 companies acquired their first money transmission license via the state nonbank licensing platform, NMLS. Today, 67 of those companies are licensed in only one state, 10 are now licensed in two to nine states, and another 15 are licensed in 10 or more states.

Innovation also means that companies might want to evolve their business plans or might even fail. State regulators enable experimentation while protecting the market and consumers, facilitating a company’s exit in an orderly manner. In the payments space, 35 companies who held state money transmitter licenses a year ago are no longer licensed.? Of these companies, 27 had three or fewer licenses a year ago. This includes large companies that might have had a change in business model or business plan that resulted in not needing to be state licensed, as well as startups or small businesses that explored money transmission and then opted to exit the activity for a variety of business reasons.

State Regulation Protects Consumers

Critically, state licensing laws and regulation empower state officials to protect consumers and police state-licensed companies for bad behavior. This is a foundational authority provided to states under our federalist system. For example, state usury laws establish limits around the terms of credit offered to consumers, and state consumer lending licensing laws outline the standards a company must meet to extend credit to consumers within the state. State regulators are the “boots on the ground,” protecting consumers from companies that run afoul of or seek to circumvent state law.

Additionally, state regulators’ consumer protection approach differs from that of their federal regulatory counterparts, and it is often more effective. They are closer to the consumer and they are locally accountable, a dynamic that greatly benefits consumers in need of regulatory assistance. When state regulators receive a consumer complaint, they work directly with consumers and companies to address and resolve the issue. State regulators treat individual consumer complaints like casework, rather than waiting to collect volumes of complaints and finally acting once a problem has been deemed "systemic" in nature.

III. State Regulators are Modernizing Payments and Consumer Lending Regulation

State regulators appreciate that technology has sparked and accelerated significant changes in the financial services industry, and that these changes present novel challenges for state regulators and the state regulatory system. State regulators have been addressing these market and regulatory challenges for many years. For example, CSBS established a first of its kind regulator working group called the Emerging Payments Task Force in December 2013. Through this task force, state regulators issued a "Model Consumer Guidance on Virtual Currencies" and "Model Regulatory Framework for Virtual Currency," leading their federal counterparts in providing regulatory answers to novel fintech questions for consumers and businesses.

In the years since, state regulators have expanded their focus to encompass a wider array of fintech activities, companies, consumer and state regulatory issues. Through a series of initiatives called CSBS Vision 2020, state regulators are reengineering the state system of supervision. It is a regulatory mindset – a clear vision of how the states are working together to advance nonbank licensing and supervision. It is the states' commitment to work toward a more consistent, coherent and networked system of state regulation, leveraging technology and data, while reinforcing strong consumer protection regulation and enforcement.

State regulators are not "going it alone" as they work to reengineer the state system. They are working closely with industry, other regulators and consumer advocates to ensure improvements to state regulation benefit both consumers and companies at the same time. Indeed, CSBS formed a Fintech Industry Advisory Panel (FIAP) made up of 33 fintech firms, primarily from the payments and consumer lending industries, to help state regulators identify problems and develop solutions in the 50-state licensing and supervisory system. CSBS frequently meets with consumer advocacy groups to ensure strong state consumer protections remain front and center as states make changes to regulation and supervision.

Several Vision 2020 initiatives are highlighted below that will bring more efficiency and standardization to licensing and supervision for payments and consumer lenders, while strengthening consumer protections and local accountability.

Improvements in State Payments Regulation

Harmonization through a Model State Payments Law: In response to recommendations from fintech and payments company members of the Fintech Industry Advisory Panel, state regulators are currently developing a model state law for money transmitters with uniform, risk-based licensing and regulatory requirements. Though each state generally uses the same framework for money transmission laws, each statute has its own unique definitions and requirements for money transfers. States also might interpret and implement laws differently, even when the statutory language is the same. A model law will enable money transmitters to build national scale more easily, improve state supervision and ensure consumer protections.

Single Exams for National MSBs: Beginning in 2021, money transmitters operating in 40 or more states will benefit from streamlined state supervision through the recently announced Money Service Businesses (MSB) Networked Supervision program. Qualifying nationwide payments firms will undergo a single comprehensive exam to satisfy all state regulatory requirements, significantly reducing their regulatory burden. The “one company, one exam” initiative will apply to 78 of the nation’s largest payments and cryptocurrency companies that combined move more than $1 trillion a year in customer funds.

MSB Networked Supervision will also help state regulators improve their processes – a crucial element of states protecting consumers while promoting national business models – and fine tune a risk-based approach to each company's operations. This approach builds on years of substantive multistate coordination that will improve oversight of large payments firms.

The single exam will be led by one state overseeing a group of examiners sourced from across the country. By relying on experts across the state system — including in cybersecurity and anti- money laundering — regulators will gain more insight while also freeing up state resources.

Streamlined MSB Licensing: State regulators recognize the pain points MSBs experience when seeking licensure in individual states, including different legal requirements, resources and turn times, procedural requirements and interpretations and satisfying these similar requirements in each state. To address these challenges, state regulators launched a Multistate Money Services Businesses Licensing Agreement (MMLA) program to create a more efficient MSB licensing process by curbing duplications in the state licensing process. To date, 28 states have signed onto the MMLA program. If one of these signatory states reviews key elements of state licensing for a money transmitter, other participating states agree to accept the findings. The process has shown to reduce the time to for a company to obtain a license by two-thirds.

The MMLA program utilizes NMLS, which is the state regulators' regtech platform. Companies can submit most license application materials only once through NMLS instead of submitting them separately to individual states. For licensing requirements that are common among the states, the applicant will also have a single point of contact with the state selected to review the common licensing requirements.

Centralized MSB Data Reporting: NMLS also facilitates state regulators' Money Services Business Call Report, which is the first and only nationwide report of its kind. The MSB Call Report yields important information about the size and nature of the industry, including cryptocurrency and money transmission, and helps state regulators to risk scope their MSB exams. Additionally, the MSB Call Report benefits companies by creating a standardized reporting requirement across all participating states.

Improvements in State Consumer Lending Regulation

Tools for Navigating the State Consumer Finance System: CSBS has developed a survey of state consumer finance licensing laws that allows users to see similarities and differences across all 50 states and Washington, DC, and gives companies, particularly new entrants, a clear look at state compliance requirements. Additionally, CSBS will soon release an updated, comprehensive catalog of state usury laws to accompany its survey of state consumer finance licensing laws.

Improving Consumer Finance Reporting: Unlike the mortgage and MSB industries, there are no national reporting standards or requirements for consumer finance companies. In response to a recommendation from the Fintech Industry Advisory Panel, the states are developing a consumer finance call report that would be deployed through NMLS. The consumer finance call report will improve the information reported to state regulators while promoting greater consistency across state reporting requirements.

Improve State-Federal Coordination of Bank & Nonbank Partnerships

Coordinate State-Federal Supervision of Bank Third Party Service Providers: Banks partner with a variety of third-party companies to provide and deliver core products, such as when banks partner with nonbank lenders to extend credit to consumers. The Bank Service Company Examination Coordination Act (H.R. 241/S. 4154) would amend the Bank Service Company Act to allow state and federal regulators to coordinate their oversight of third-party service providers (TSPs). Improved TSP supervision will support both banks and nonbank companies that partner together to deliver innovative products and services to consumers. State regulators are pleased that the House approved H.R. 241, the Bank Service Company Examination Coordination Act, in a unanimous vote a year ago and hope the Senate swiftly approves the companion bill, S. 4154, that was introduced in July.

IV. State Regulation of Banks Engaged in Payments and Lending

State Regulators Provide Robust Oversight of Bank Payments and Lending Activities

In addition to licensing and regulating discrete financial activities conducted by nonbank companies, such as payments or consumer lending activities, state regulators are also “entity- based” regulators in that they charter and supervise 79 percent of all U.S. banks. Bank charters provide these organizations with a much broader array of business powers, including the ability to accept deposits, facilitate payments and extend credit to consumers and businesses. Banks also expose taxpayers and the federal government to the risk of losses in the event of failure, and are therefore subject to more rigorous “cradle-to-grave” regulations, such as stringent capital and liquidity requirements, community reinvestment requirements, merger and affiliation restrictions, and prior approval or notice requirements for a significant portion of their activities. State regulators supervise banks’ payments and consumer lending activities as part of a comprehensive prudential regulatory and consumer protection framework, ensuring these particular activities do not pose undue risks to the broader organization or harm consumers.

State Regulators Provide Robust Oversight of Unique Bank Charters

Throughout history, Congress has recognized and reaffirmed the role states play as “laboratories of innovation,” including in the bank chartering space. For example, Congress has authorized and retained exemptions in the Bank Holding Company Act (BHCA) that allow nonbank parent companies to own insured bank subsidiaries. Commonly referred to as industrial loan companies (ILCs) or industrial banks, commercial firms can own an ILC without being subject to the activity restrictions of the BHCA.

Despite these parent holding company exemptions, ILCs are subject to the same banking laws and regulations as other depository institutions. ILCs undergo the same comprehensive exam events as all banks, namely: safety and soundness, BSA, IT, consumer compliance, CRA and, where applicable, service provider exams. These exams are performed by the state chartering authority and the Federal Deposit Insurance Corporation (FDIC). The ratings framework, exam cycle and exam procedures used at ILCs are the same used at every other bank.

When an ILC missteps, regulators use the same enforcement tools to drive corrective action. ILCs must comply with anti-tying regulations and the limits on affiliate transactions required by Sections 23A/B of the Federal Reserve Act. Insured depository institutions, not their parent companies, access the federal safety net (i.e., deposit insurance, the payment system and the Fed’s discount window). Because of this, the ILC charter is a useful, statutorily authorized, option to allow innovation to develop safely inside the bank regulatory system, while simultaneously ring-fencing that exposure to an insured depository.

V. State Regulators’ Concerns with the OCC’s Proposed “Fintech” and Payments Charters

The OCC Lacks the Requisite Legal Authority to Charter Nonbank Firms

State regulators strongly oppose the Office of the Comptroller of the Currency’s (OCC) efforts to accept applications for special purpose national bank charters from nonbank fintech companies that do not and would not engage in receiving deposits or be insured by the FDIC. State regulators have made that point in court filings and are pleased that a

New York federal court ruled against the OCC in its attempt to license fintech firms. In July, CSBS filed an amicus brief supporting the New York Department of Financial Services in the Second Circuit as the OCC appeals the federal court decision.

Recent statements suggest that the OCC may seek to offer charters to payments companies that do not take deposits. This purported “payments” charter is substantively the same “fintech charter” that, as noted above, a federal court has invalidated.

We have a federated financial system that has been affirmed by Congress. Federal and state laws determine how financial entities are regulated and are the reason the New York federal court ruled against the OCC in its attempt to license fintech firms.

First, the OCC does not have the statutory authority to issue federal banking charters to nonbanks. Congress decides what a bank is, and in our view, what the OCC is trying to do with the fintech charter is inconsistent with the banking laws that Congress has enacted. Second, a federal fintech charter would distort the market by picking winners and losers, by only drawing from a handful of large, established entities and giving them a competitive advantage over new market entrants that have historically injected innovation into our financial system. Third, a federal fintech charter would preempt important state consumer protections. Fourth, such a charter would dismantle the separations of banking and commerce put in place by Congress and extend the federal safety net to a wide swath of commercial institutions, potentially exposing taxpayers to losses.

There is no difference between the OCC’s proposed fintech charter that the New York federal court invalidated and the OCC’s new payments charter proposal. Both are invalid because the OCC does not have blanket authority or power to define what it means to be a bank. A federal charter — or really, the federal authorization to do business — is the exception, not the rule under the U.S. Constitution. Congress must establish the authority to confer such a charter and does so only to serve compelling public policy goals. Congress has repeatedly left supervision of nonbank companies to the states.

An OCC Nonbank Fintech or Payments Charter Would Lead to Consumer Harm

State licensure and supervision of nonbank financial companies provides greater consumer protection through a combination of state usury laws, state licensing requirements and other state consumer protection laws. An OCC fintech or payments charter would seek to preempt these critical, state-level consumer protections, leaving consumers with less recourse and fewer options if they are the victim of predatory business activities.

State Usury Laws Protect Consumers from Harmful Credit: State usury laws cap the interest rates and finance charges that a business can charge in lending money. States have set these interest rate caps at different levels in balancing the competing policy priorities of credit access and credit affordability. With the fintech charter and other efforts, the OCC is seeking to extend to nonbanks the ability to export interest rates which is currently reserved to banks.

If nonbanks are allowed to export interest rates, then consumers will no longer be able to exercise control through democratic processes over the cost of credit offered within their state. In recent years, democratic participation has enabled consumers to lower the interest rate caps in their states, even to the point of banning payday lending within their state. For example, in 2010, Arkansas citizens voted to pass a ballot initiative to amend their state constitution to establish a 17 percent annual rate cap for consumer credit extended to Arkansas residents. This effectively banned payday lending in Arkansas. If the OCC is to succeed in its project to extend interest rate exportation to nonbanks, then initiatives like those seen in Arkansas will be no more, for the Comptroller will have taken away the ability of consumers, as citizens, to play a role in setting policies that significantly impact their economic destiny.

State Licensing Laws Limit Potential Consumer Harm: State licensing laws require nonbank financial services providers to adhere to restrictions on their business practices and restrictions on product terms, limiting the universe of potential harm consumers could experience at the hands of inexperienced or unscrupulous businesses. The state licensing process serves a critical “gatekeeping” function for the financial services industry, giving state regulators an opportunity to fully vet applicants who wish to conduct financial activities with consumers in their states.

State Fair Lending and Anti-Discrimination Laws: Unlike a state regulator, the OCC is not directly accountable to state legislatures for not applying State Fair Lending and Anti-Discrimination Laws, and, because state oversight is preempted, state regulators cannot check or fill the regulatory void left by the OCC’s non-enforcement of the laws. Such a void is likely based on the OCC’s record of non-enforcement of state fair lending and anti-discrimination laws in the years leading up to the 2008 financial crisis.

VI. Conclusion

State regulators applaud the Task Force on Financial Technology for convening this important hearing on the legal framework for lending and payments activities. We have a financial regulatory system grounded in cooperative federalism that has served as the foundation for incredible innovations in payments and lending. We appreciate Congress’s repeated affirmation of this structure and of the important regulatory role of the states. State regulators look forward to partnering with Congress and with the members of the Committee and this Task Force in ensuring effective and locally accountable oversight that protects consumers and promotes economic development in our communities.

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