EXAMINING OPPORTUNITIES FOR FINANCIAL MARKETS IN THE DIGITAL ERA

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

SEPTEMBER 28, 2018

Printed for the use of the Committee on Financial Services

Serial No. 115–121

U.S. GOVERNMENT PUBLISHING OFFICE
32–372 PDF WASHINGTON : 2018

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EXAMINING OPPORTUNITIES FOR FINANCIAL MARKETS IN THE DIGITAL ERA

Friday, September 28, 2018

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9 a.m., in room 2128, Rayburn House Office Building, Hon. Blaine Luetkemeyer [chairman of the subcommittee] presiding.

Present: Representatives Luetkemeyer, Rothfus, Lucas, Posey, Pittenger, Barr, Tipton, Trott, Loudermilk, Kustoff, Tenney, Hensarling, Clay, and Green.

Chairman LUETKEMEYER. The committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time. This hearing is entitled, "Examining Opportunities for Financial Markets in the Digital Era." And before we begin, I would like to thank the witnesses for their participation today and for appearing before us. Hopefully, this will be a little less drama than the hearings on both sides of the building yesterday.

Before we begin, I think that we are going to have some great information to discuss today, and I thank you again. And so I now recognize myself for 3 minutes for the purposes of delivering an opening statement.

This hearing is in regard to the U.S. Department of Treasury report entitled, "A Financial System That Creates Economic Opportunities, Nonbank Financials, Fintech, and Innovation." Last January, this subcommittee held a hearing to examine developments in digital technology. Even since that time, the various ways financial services are offered and delivered, has changed.

Today, we continue our quest to examine the fintech landscape and approaches to a smart and sufficient regulatory regime. This hearing will expand on the recommendations of the Treasury report and examine the current landscape, including the need to modernize the existing regulatory framework, and develop legislative proposals to allow financial services entities to deliver new products and services to customers.

The pace of technological development in financial services has increased exponentially and dramatically, offering both benefits and potential challenges to the U.S. economy and consumers. The reality is that innovation is critical to the success of industry and the development of new products. It helps to serve consumers' financial needs across the globe, as well as potentially reduce operational risks of financial institutions.

As more information becomes digitized, the protection of consumer data becomes particularly important. We can't address innovation and growth without addressing the security of that data. I am glad the Treasury report made that a priority. The Department has clearly outlined the need for a single Federal data security and notification standard that raises the bar for all industries, and ensures a better outcome for all consumers.

State authorities have attempted to harmonize standards, but the results have been stunted. For every State that has enacted a tough consumer notification requirement, two others have failed to address the issue. Harmonization must be a priority.

Two weeks ago, the Financial Services Committee passed the Consumer Information Notification Requirement Act, my bill, that would codify data security safeguards, and establish, for the first time in history, a mandatory consumer breach notification provision for all financial firms. The biggest challenge to innovation is regulatory duplication and fragmentation. Outdated and problematic regulations need to be overhauled, and growth must be monitored, but not necessarily slowed.

We have a very distinguished panel of witnesses before us. The committee looks forward to hearing your diverse perspectives and appreciates the time you have taken to appear today. Thank you for your testimony. As Mr. Clay is not here, we will recognize him upon his appearance for an opening statement. But I do believe we need to continue, as we do have votes scheduled here, I think it is now 11 o'clock.

So with that, the Chair now recognizes the Vice Chairman, the member from Pennsylvania, Mr. Rothfus, for 2 minutes for an opening statement.

Mr. ROTHFUS. I thank the chairman for yielding and for calling today's hearing. Our financial sector has undergone significant changes in the past few years. We have witnessed a distressing trend of consolidation and closures, driven, in part, by overregulation. As a result, some communities have lost their local bank, and some communities have lost access to services that they previously enjoyed.

Regulatory reform and technological advances can help the financial sector regain its vibrancy. I am encouraged by ongoing developments in the fintech space. It is important to note, as some of our witnesses will do today, that fintech and traditional banking do not need to be adversarial. Bank/fintech partnerships are common, and they can help institutions augment their services and reach new customers.

I am encouraged by this Administration's work to ensure that nonbank lenders and fintech firms are subjected to clear and robust rules, while facilitating continued technological progress and allowing for healthy competition. I look forward to hearing from our witnesses. And I yield back.

Chairman LUETKEMEYER. The gentleman has yielded back. The Ranking Member prefers not to have an opening statement. So with that, we will go right to the testimony today. We thank all of you for participating.

Mr. Aaron Cutler, Partner for Hogan Lovells, LLP; Mr. Dion Harrison, Director of Elevate; Mr. Michael Price, President and Chief Financial Officer, First Commonwealth Financial Corporation, on behalf of Pennsylvania Bankers Association. And Mr. Rothfus would like to make a special introduction of him.

Mr. ROTHFUS. Thank you, Mr. Chairman. Yes, Mr. Price is the President and Chief Executive Officer of First Commonwealth Financial Corporation in Western Pennsylvania and a constituent of mine. He sits on the board of the Pennsylvania Bankers Association, and he also serves on the Community Depository Institutions Advisory Council of the Cleveland Fed and the Business Advisory Council at Indiana University of Pennsylvania.

Mr. Price grew up in Johnstown, Pennsylvania, which is also in my district. He earned a degree in finance from the University of Utah, and an MBA from Cleveland State University. Mr. Price, thank you for testifying today, and I look forward to getting your perspectives. I yield back.

Chairman LUETKEMEYER. The next panel member is Mr. Scott Astrada, Director of Federal Advocacy, Center for Responsible Lending (CRL); and Mr. Stuart Rubinstein, President, Fidelity Wealth Technologies.

Each of you are recognized for 5 minutes to give an oral presentation of your testimony. Without objection, each of your written statements will be made part of the record. Just a little bit on the lighting system. Green means go; yellow means you have 1 minute to complete; red means, hopefully, we can wrap it up very quickly and stop. We do want to get done by 11 o'clock, not that this is not an important. We want to make sure everybody has a chance to get all their questions asked, and make sure all the answers are here. But we do need to make this as compact as we can.

So, with that, again, I indicated to you, please pull the microphones close to you. The lady at the end needs to transcribe the activities and needs to be able to hear everything that happens. As I told you, my wife screamed in both ears and I have a hearing deficit problem, so you need to pull it close so I can hear. So, we are excited, though, for all of you to be here today.

And, Mr. Cutler, you are recognized for 5 minutes.

STATEMENT OF AARON CUTLER

Mr. CUTLER. Thank you, Chairman Luetkemeyer, Ranking Member Clay, and members of the subcommittee. My name is Aaron Cutler and I am a partner at the law firm of Hogan Lovells. Any statements I make reflect only my opinions, and do not necessarily reflect the opinions of my law firm, colleagues, or clients.

My full written testimony has been entered into the record, and I will now give an overview. At the outset, I would like to stress that I support agile and effective regulation that enables the creation, development, and deployment of safe, sound, and innovative consumer financial products and services.

Fintech products and services are already in use and continue to be rapidly adopted. As noted by the Treasury's recent report, up to one-third of U.S. consumers who are online use no less than two fintech services. As GAO reported in 2016, the U.S. financial services regulatory structure is complex, and contains areas of fragmentation of overlap that lead to an inefficient regulatory structure.

Several of the recommendations contained in the Treasury report identify areas for improvement and increased efficiencies. Overall, the Treasury report is a call to action. Taking action on many of the recommendations could improve the regulatory framework. These improvements stand to benefit fintech entities, the industry at large, and consumers.

Financial institutions are sitting on a gold mine of insightful data about each of their customers' spending habits and use of funds. In the right hands, this data can be used to promote sound financial management, assess risk, and support consumers. It can also help with digital identity, verification, or even to make risk assessments for insurance products.

In many cases, however, it is not the financial institutions themselves that are best able or motivated to carry out this analysis, but innovative third parties with greater expertise in data analytics. However, financial institutions and data aggregators often find themselves at odds over data sharing, this is in part due to the prevailing regulatory regime.

Currently, financial institutions face uncertainty regarding their liability for sharing consumer account data. The Treasury report recommends that the Bureau confirm that third parties given consumer authorized access be covered under the definition of consumer under Dodd-Frank for the purpose of sharing financial account and transaction data, thereby, requiring financial institutions to share the data with these third parties.

In my view, the overriding concern when setting a framework for open access to transactional information should be to ensure the security of the Count and credentials, facilitate the customers' freedom of choice, and to allocate risk and liability appropriately to protect the customer. Many fintech companies are subject to the authority and supervision of State banking departments and other financial services regulatory agencies. Under the State regulatory regimes, fintech companies are often required to obtain some form of State licensing and registration.

State applications may ask for detailed information about the company, key employees, executives, and owners. The information requested may also slightly vary between States, even though the objective is substantially similar. The Treasury report identifies the State oversight and harmonization challenges faced by entities offering financial services products across multiple States.

Thus, it recommends creating uniformity to streamline State supervision and licensing, such as adopting reciprocity-type measures to help reduce redundancies in the licensing and registration process. I fully support this recommendation.

Regulators and industry participants alike will also benefit from the information obtained by testing new innovative technologies. The purpose of a regulatory sandbox is to create an environment for firms to try out new ideas without the threat of regulatory penalty. By providing this environment, regulators expect to create a range of beneficial outcomes, such as reduced time to market for new products and services due to firms having greater certainty as to the regulatory treatment of those products and services; better access to finance for firms seeking to raise funding for their new products and services due to investors having greater comfort that the business will be viable from operational and regulatory perspective; the development of more innovative products due to firms having the ability to test ideas and the support of regulatory environment; and better outcomes for consumers due to the better quality of testing that can be applied within a sandbox environment.

Also, the use of the sandbox enables the regulators to provide input on consumer protection features at an earlier stage of the product development process. In the U.K., for example, the financial conduct authority has established a domestic regulatory sandbox, which has been used as a model for other sandboxes around the word.

In conclusion, the Treasury report is a very good start, and I commend the Treasury Department on its publication. Thank you.

[The prepared statement of Mr. Cutler can be found on page 56 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Cutler. Mr. Harrison, you are recognized for 5 minutes.

STATEMENT OF DION HARRISON

Mr. HARRISON. I want to thank Chairman Luetkemeyer and Ranking Member Clay for asking me to appear today to discuss opportunities for financial markets in today's digital era.

My name is Dion Harrison, and I am the Director of Products at Elevate. I have over 20 years of experience in the consumer credit industry, and now, I am proud to work at Elevate, one of the leading fintech companies in the United States. I am proud because we work hard to fulfill our mission to serve good customers in disadvantaged circumstances today, and provide products that help them to have a better tomorrow. We are also building consensus around key policy issues through our trade groups, Teknek, and the Online Lender Alliance.

Headquartered in Fort Worth, Texas, and with an office in San Diego, we served over 2 million American families through the origination of almost $6 billion in nonprime credit to date. We are the only fintech company to cap our profits so we can reduce costs to consumers. We have lowered our APRs by over 50 percent since 2013, saving consumers over $4 billion compared to payday lenders. And we have a customer centric approach to designing and underwriting all of our products.

As members of this subcommittee know, the U.S. is still recovering from the events of 10 years ago, which have significantly reduced the credit available to nonprime consumers by over $140 billion to date. Banks took a step back and small dollar options for consumers evaporated, the 160 million Americans with credit scores below 700, who we call the new middle class. To truly understand the needs of consumers affected by these changes, Elevate created a research institution called Center for the New Middle Class. The results of our research so far has given us key insights.

African Americans are 80 percent more likely to live paycheck to paycheck, they are also 2–1/2 times more likely to overdraft their bank account. Hispanic nonprime borrowers are more likely to experience higher levels of employment and less volatile income, but less than 1 in 10 have a retirement account.

What rings true about our research is that these Americans need access to better small dollar loans, and my experience tells me that partnerships between fintech companies and banks are the key to building safer, more accessible, and inclusive financial products. Fintech is already helping consumers by increasing short-term credit access, developing payment platforms, and helping consumers make better financial decisions with new tools.

To build upon the momentum in our industry, Congress and industry stakeholders should come together on the following principles: Regulations should be pro-consumer and enable innovation. Partnerships between banks and fintech companies should be encouraged. Congress should act by passing legislation that clarifies and fuels the creation of safe, superior products.

As with any innovation, there will be staunch supporters and fierce critics, but I am confident through transparency, honesty, and results, Congress will see that leveraging the strengths between banks and fintech companies is a powerful and positive solution to filling many of the gaps in our financial system. Bank/fintech partnerships are a win, win, win. Banks are able to offer products to position themselves for the future of a rapidly evolving industry.

Fintech companies like Elevate are able to efficiently utilize data and analytics to better design and market safe financial products. And consumers get access to credit solutions that are quick, safe, and transparent. Consumers are also able to escape bank deserts, as Representative Meeks recently noted, fintech products can build a truly affordable and healthy financial system for everyone.

Congress should ensure consumers continue to benefit from these partnerships. I first want to thank this committee and the House for passing a large bipartisan majority, H.R. 3299, which clarifies valid-when-made. Similarly, I hope this committee will pass H.R. 4439, which clarifies the true lender issue.

Furthermore, we must address the lack of diversity in fintech and technology more broadly. As Congressman Cleaver recently stated, there are serious ramifications when companies don't have a diverse workforce and don't understand or align with the communities that they serve.

We must work hard to hold each other accountable. In our business, we use alternative data sources to reach new consumers and evaluate the risk drivers and affordability and delinquency, but we must remain vigilant that our processes do not include bias. And we must all be on the lookout for bad actors who intend to create predatory products targeted at not just nonprime, but all groups of consumers.

I want to thank you for inviting me today, and I look forward to answering your questions.

[The prepared statement of Mr. Harrison can be found on page 83 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Harrison. Mr. Price, you are recognized for 5 minutes.

STATEMENT OF T. MICHAEL PRICE

Mr. PRICE. Thank you. Chairman Luetkemeyer, Ranking Member Clay, and members of the subcommittee, my name is Michael Price and I am the Chief Executive Officer of First Commonwealth Bank.

Our community bank is privileged to help thousands of consumers and family owned businesses buy homes, pay for college, expand facilities, and hire new workers every year. I am grateful for the opportunity to participate in this important hearing and offer my perspective as a community banker.

In my brief testimony, I want to stress three points: First, community banks embrace and support responsible innovation within our industry; second, I want to stress the vital and visible presence of community banks throughout the country; third, I want to emphasize that consumers and small businesses are best served when all providers of financial products and services are subject to a consistent and level regulatory and supervisory playing field.

First Commonwealth has served as a trusted provider of financial services for over a century. We embrace innovation to better serve our customers. Financial technologies present tremendous opportunities to customers and banks alike. Technology empowers consumers to manage their financial health, and affords access to credit for more borrowers. We continuously invest in technology to provide state-of-the-art solutions for mobile banking, mobile wallets, and mobile deposit through a financial management application that teaches and empowers our customers to budget, save, monitor spending, and plan for the future.

Our innovation occurs within the framework of bank regulation and supervision, and a culture of compliance and risk management that ensures that all new products are safe and secure before they get into a customer's hands. In short, the community banks deliver innovative products through channels customers can trust. However, technology does not replace a community presence.

While First Commonwealth is embracing technological innovation, we remain a visible presence supporting our communities, as we always have, through countless hours of volunteering, something that cannot happen through a computer or mobile device. We understand our customers, and stand behind them in good times and bad. We engage with our communities, partner with local businesses, and will have the capital and wherewithal to lend through the next economic cycle. We make a difference.

My team in Indiana, Pennsylvania serves in leadership roles at a local university, hospital, drug treatment facility, high school, Chamber of Commerce, United Way, YMCA food bank and homeless shelter, just to name a few organizations. Besides our time, we also give generously to these local charities and many more. We care about the vitality of our communities.

As a community bank, First Commonwealth is appropriately subject to extensive regulation and regular and rigorous examinations. We adhere to regulatory guidelines for vendor risk management to ensure that service providers have robust compliance and information security programs. Nonbanks offering similar services do not have the same level of oversight. This can allow problems and security vulnerabilities to go undetected to the detriment of consumers. As a bank, we are regularly examined for fair lending compliance.

While nonbank lenders may be subject to fair lending laws, they are not routinely examined for compliance unless a consumer complaint triggers an investigation. I believe customers should expect the same reliable experience and protections, whether they are dealing with a bank or a nonbank.

The best way to achieve a consistent customer outcome is for regulation, and more appropriately, supervision to be based on activity rather than the type of company that conducts the activity.

Many of the innovations at their core are traditional banking products offered in new ways. By focusing on the activity taking place, regulators are best able to assess the risk, being presented to consumers and the system. Activity-based regulation and supervision would level the playing field and ensure that consumers enjoy the same protection of benefits across the vast landscape of financial service providers.

Once again, thank you for the opportunity to offer my perspective, and for your attention to the importance of responsible innovation in financial services. Thank you very much.

[The prepared statement of Mr. Price can be found on page 90 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Price. Mr. Astrada, you are recognized for 5 minutes.

STATEMENT OF SCOTT B. ASTRADA

Mr. ASTRADA. Thank you. Good morning Chairman Luetkemeyer, Ranking Member Clay, and members of the committee. Thank you for inviting me here today to testify about the opportunities and challenges posed by fintech in the financial services marketplace, the current regulatory and consumer protection landscape, and the need to ensure that emerging products and market participants best serve consumers.

I am the Director of Federal advocacy at the Center of Responsible Lending, a nonprofit, nonpartisan research and policy organization, dedicated to protecting homeownership and family wealth, by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a non-profit community development financial institution. In total, Self-Help has provided over $6 billion in financing to 70,000 home buyers, small businesses, and nonprofits. And currently serves more than 80,000, mostly low and moderate consumers, through 30 retail branches.

This important hearing addresses how technological innovation has resulted in the development of new services and delivery platforms by both traditional financial institutions and nonbank fintech companies. The rapid expansion of market participants and their products has brought new opportunities as well as significant consumer protection concerns to the financial marketplace.

In my written testimony, I discussed in detail the essential legal questions and consumer protection issues that are necessary to be at the center of this broader fintech dialog. Specifically, in relation to the recent Treasury fintech report, CRL, along with numerous civil rights groups and State attorneys general, have expressed significant concern about the impact that the Treasury report's recommendations would have upon consumers.

We reviewed the report, as we do fintech in general, in the context of our central priorities. First, preserving the progress made by State and Federal stakeholders to guard consumers from predatory debt trap products. Second, ensuring fintech lending evolves in cadence with existing and developing consumer protection laws. And, third, the preservation of State usury laws. CRL is very wary of unscrupulous actors and payday lenders adopting the banner of fintech for the purpose of evading consumer protection laws, particularly State level rate caps, while also using the veil of innovation as a justification for exemption from longstanding consumer protection laws and regulations.

Ultimately, there is no getting around the fact that a bad loan is a bad loan, regardless of whether it is delivered through a technologically advanced medium or algorithm or storefront. At that same time, we are well-aware and very encouraged by the potential benefits of fintech, especially as it relates to affordability and financial inclusion.

CRL is dedicated to ensuring that consumer marketplaces are fair, transparent, and equitable, and we are appreciative of the opportunity to contribute to this discussion. While we are all admittedly unsure of what fintech can deliver over the long term, in terms of financial inclusion, we do know for a fact what happens when consumers are left in the cross-hairs of predatory lenders.

Short-term payday loans and car title loans cost borrowers $8 billion a year, and many times lead to other significant financial challenges, overdraft fees, loss of a checking account, debt collection costs, even bankruptcy. The evolving fintech marketplace should focus on historically proven consumer protection laws and the components of responsible, equitable, and wealth building lending. We have a unique opportunity with the emergence of fintech to build strong consumer protections and equitable financial access at the front end of fintech development, and into the very foundation of the marketplace itself.

Furthermore, we have an opportunity to correct and remedy the current marketplace inequities that have been systemic by ensuring consumer protections is an integral part of the financial marketplace. If we get this wrong, we will set the stage for future generations to suffer from the same financial inequities of the past. However, if we do this right, we could set a trajectory for millions of Americans toward economic prosperity.

Thank you again for the opportunity to testify, and I look forward to answering your questions.

[The prepared statement of Mr. Astrada can be found on page 32 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Astrada. Mr. Rubinstein, you have a really high bar to hit here because every one of those guys came in under the 5 minutes.

Mr. RUBINSTEIN. Thank you.

Chairman LUETKEMEYER. You are recognized for 5 minutes, sir.

STATEMENT OF STUART RUBINSTEIN

Mr. RUBINSTEIN. Thank you, Chairman Luetkemeyer, Ranking Member Clay, and members of the subcommittee. My name is Stuart Rubinstein, I am President of Fidelity Wealth Technologies and head of data aggregation at Fidelity Investments. Fidelity is a leading provider of investment management, retirement planning, brokerage, and other financial services to more than 30 million individuals, institutions, and intermediaries, with more than $7 trillion in assets under administration. We are also strong supporters of fintech and a major fintech investor.

I am appearing today to represent Fidelity with a specific focus on the topic of financial data aggregation. At Fidelity, we have a unique perspective: We are an aggregator ourselves, and we are also a source of data to aggregators who act on behalf of our customers.

Fidelity is a strong believer in the benefits our customers receive when they can see a consolidated picture of their finances. We have offered aggregation services to our customers for well over a decade, and our customers have been able to access their Fidelity data through various third parties since the 1990's. But the cybersecurity environment has changed, and risks have become far more pronounced and must be addressed.

First, most financial data aggregation that occurs today requires consumers to disclose their financial institution, user name and password, to the third party aggregator or fintech. While this process may have worked in the past, there are new technologies that eliminate any such requirement. Because cybersecurity is of paramount importance, we believe that customers should not have to disclose their user name and password in order to use any third party service.

Second, aggregators using credentials may have access to an entire website or mobile app, which means they can access more data than may be necessary to provide their services. For example, a simple app that tracks your spending does not need to know your investment holdings, but it will have access to that under the current methods. Because of the advancement of cyber threats, Fidelity and others in the industry having been working hard on developing a different approach to data aggregation that helps to protect consumers. At Fidelity, we have developed five principles for empowering consumers to share their data safely with third parties:

One, consumers should be able to access their financial account data wherever they want, when they want it, and through third parties. The question is not if they can access their data, but how; two, access must be provided in a safe, secure, and transparent manner; three, consumers should provide affirmative consent and directly instruct their financial institutions to share their data with specific third parties; four, third parties should access only the financial data that they need to provide their services. This should not be a Trojan horse for the gathering, accumulating, and reselling of consumer data; and fifth, consumers should be able to monitor account access rights and direct financial institutions to revoke that access.

To back these principles with action, Fidelity announced in November 2017, a new service called Fidelity Access. Fidelity Access will allow customers to provide third-party access to their customer data through a secure connection, and without providing log-in credentials to any third party. The most difficult issues standing in the way of wider adoption of safer data sharing technologies is the issue of responsibility. We believe companies that collect and handle financial data should be responsible for protecting that data and making consumers whole if misuse, fraud, or theft occurs.

As we have been discussing Fidelity Access, we have seen aggregators try to limit liability, some to very small dollar amounts. Fidelity believes firms that obtain and handle consumer data should be held responsible to protect that data from unauthorized use, just as we are. Any other standard creates moral hazard and does not require aggregators to take their data stewardship responsibilities seriously.

Finally, the complexity of 50 different State laws to notify a consumer of data breach is significant. We are encouraged by the committee's recent consideration of legislation to create a single Federal data breach notification standard. Consumers could benefit from a uniform Federal standard that requires clear and timely notification of a material breach of personal information.

Thank you again for the opportunity to testify before you today. I look toward to answering your questions.

[The prepared statement of Mr. Rubinstein can be found on page 100 of the appendix.]

Chairman LUETKEMEYER. Thank you, Mr. Rubinstein, well done. The Chair now recognizes himself for 5 minutes to begin the questioning.

Mr. Cutler, you have written extensively on the growing fintech marketplace and what the challenges are and innovation. I know you talked a little bit about the regulatory sandbox. How do you believe that it is best structured? Is it to allow the fintech company before it is chartered, after it is chartered, whenever it becomes a part of a bank or credit union or other entity, or should you just allow the fintech company, before it ever becomes affiliated, to be in the sandbox to develop its products? Can you just elaborate, please?

Mr. CUTLER. Thank you, Mr. Chairman. Actually, I think before they become a fintech, before they get their charter would be a good place to allow them to enter the regulatory sandbox early on in that process, as they are trying to figure out where they should go, should they enter into a partnership. As they are figuring it out, it would be good if they could be part of that sandbox.

Chairman LUETKEMEYER. I would assume that company would have to show that it is viable to be able to be doing something like that. You can't just have somebody come in with an idea and a whim and be able to get a safe harbor here to go and develop a product—would that be—

Mr. CUTLER. Absolutely, they would have to open the kimono with the regulators at that point and have that conversation.

Chairman LUETKEMEYER. Very good. Mr. Price, you talked a little bit about some of your fintech activities, and last night I met one of Mr. Barr's constituents, who is a banker from Lexington, and they were using tellers at kiosks. Instead of a real teller, it was a teller who was technologically behind the screen somewhere and they were able to talk to him on another screen in the lobby. So they didn't really have any physical people in the lobby, but they had some physical people actually doing all of this.

Have you done some research to see—I guess I am curious about the numbers, what people would be interested in this? Last night the banker was adamant about they did the research to show this is something people wanted, but I saw some numbers recently that indicated, even the millennials, only 6 percent of the people didn't want to touch somebody, 51 percent of them did want to touch somebody, they wanted to be able at some point be able to go to a teller and be able to talk across the counter. What numbers can you talk to us about this morning?

Mr. PRICE. Thank you, Mr. Chairman. The number I recently saw actually 2 days ago from an industry expert was 46 percent of people still go in the branch, and then now 54 percent do things totally digitally. And when they have a problem, they still want to get somebody by the throat or hold their feet to the fire and get in front of us at the branch. But those are the basic numbers. And I have to tell you, I think Congressman Rothfus said, this is an adversarial, it really isn't. We have mobile wallets. We have online lending. We have the same kinds of—the kiosk idea, we think about our customers, interface digitally, those of the types of things we are exploring as we speak. Umpqua just in the last week came out with a concept, Best Banker Forever, where you are interacting with a person mobily.

So these—the fintech companies have really pushed the space, and I think will make it terrific for clients, and we look for all kinds of opportunities to partner with them, and, in fact, we are already doing that.

Chairman LUETKEMEYER. I assume there needs to be some structure in place to be able make sure this is done. Now, Mr. Rubinstein made some great points here with regards aggregating data and access for people to their data, but also trying to find a way to protect that data. There is a line you have to walk here.

Mr. PRICE. There is. And I would just say, a bank charter is a bank charter. No bank-like charters, regulatory oversight exams, if you are engaged in banking activity, and that includes the full enchilada, things like CRA (Community Reinvestment Act), HMDA (Home Mortgage Disclosure Act), fair lending. And not just laws, but also you have to have supervision. When the examiner comes in and takes 40 or 50 of my loans and grades them, that is a different bar than if somebody sues me civilly, because I am accountable quarterly for exams and exam outcomes.

Chairman LUETKEMEYER. Mr. Rubinstein, would you like to comment on that last comment? Elaborate on your testimony?

Mr. RUBINSTEIN. Very simply, different firms have consumer data, and right now are held to different standards. We have banking standards, the SEC has standards on firms like us. Fintech firms are able to use that data and provide very helpful services, but they are not subject to the same standards. And I think that is—at the end of the day, it is important to have a level playing field. But I don't believe the consumer understands the difference if one firm holds the data or another firm does, we just want to make sure we have those same protections.

Chairman LUETKEMEYER. Thank you. My time has expired. And with that we go to the gentleman from Missouri, the other gentleman from Missouri, Mr. Clay is recognized for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman. And let me thank the panel for their participation in this hearing. I will start with Mr. Astrada. I see that the Center for Responsible Lending was listed in Treasury's fintech report as being an organization the Department consulted with. Can you please share with us how your meetings with the Department went, and did they take your advice?

Mr. ASTRADA. Thank you, I am more than happy to share. I will start that we did not actually meet with Treasury, despite being listed in the appendix. To be as forthcoming with the committee as possible, the process was earlier this year, Treasury staff reached out to us to come in and talk about the report, and I was the designated lead. I responded and said we would love to come in and talk, as we usually do. I did not receive a response to that email. I followed up a few weeks later and did not receive a response to that email, and followed up one last time a month after that, and did not receive a response.

So we were quite surprised to be listed in the appendix. We assumed the best, in that it was a technology oversight.

Mr. CLAY. I wouldn't go that far, but I am sure that is something Treasury can answer for us. Let me ask you, what are your views on creating some regulatory sandbox for fintech? Are there certain aspects of the fintech landscape that would be better suited for such a sandbox? And what parameters would you place on a sandbox?

Mr. ASTRADA. That is a great question. And I will zoom out from the consumer experience aspect of it in terms of the terminals and branches and talk the policy and process aspects and our concerns with that. On a broad level, it really is a bad deal for consumers. It is trading well-established, long-established consumer protection laws, especially as it comes to civil rights and anti-discrimination for the promise of innovation for the broader society.

I think one of our, just initial issues is innovation is one of those terms that if you ask 10 people what it means, you get 11 answers. And that can be really stretched, either from a product level or even nefariously in terms of delivering predatory loans through new technological platforms is not innovation, and is not deserving of any exemption, in fact, quite the opposite. And I think the process of cutting out stakeholders, consumer groups, civil rights groups, not going through notice and comment, not going through the well-established APA procedures, to, again, double-down on this notion of a very vague conception of innovation is very problematic.

And on the consumer level, if you really talk about the permanency of some of the negative impacts that can follow individuals their whole lives, if not generations, you might have a great exit plan in a business if it fails, but what about those consumers? And the only thing that comes to mind is an Atlantic article from earlier this year, based on an MIT study, that says, To escape poverty, on average, you need 20 years for nothing to go wrong. No medical emergency, no job loss. That is a crazy amount of time.

And if you talk about regulatory sandbox, especially in financial inclusion, you set up for a tradeoff between well-established civil rights laws for this promise of innovation that is not even strictly defined, and the consequences can follow individuals for their whole lives.

Mr. CLAY. And just as a follow up to Mr. Harrison. How does Elevate protect against unintentional discriminatory practices?

Mr. HARRISON. So, thank you, Congressman Clay, for that question. Elevate is very focused on making sure that we protect our customers in every way. And we have leveraged a lot of different types of data in order to more broadly serve customers that are in disadvantaged areas. And, in fact, we take it very seriously to make sure that we are in compliance with regulations also. We are subject to, with our bank partnerships, we are subject to the same regulations that all of our banking institutions are. And we do internal reviews ourselves so that we can make sure we are monitoring and checking ourselves for our fair lending practices, but we also get third party validation of all of those. Those are independent reviews that we do on a very regular basis to make sure that we are in compliance with those.

Mr. CLAY. And the brick and mortar banking industry?

Mr. HARRISON. Yes, sir. And we absolutely, whenever we partner with a banking partner, we adopt their policies on fair lending and such, so that we are always subject to those regulations, and we hold ourselves accountable to that. And we provide our reporting of the independent audits, and they have the rights to come in and audit us as well to make sure we are in compliance with all of those policies.

Mr. CLAY. I am sorry, Mr. Chairman, I went over.

Chairman LUETKEMEYER. That was a great question. Thank you. Thank you for that. The gentleman's time has expired. With that, we go to the gentleman from Pennsylvania, the Vice Chair of the committee, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman. Mr. Price, I want to talk a little bit about something you said in your testimony about the importance of having a community presence. As we see the ongoing evolution in society, things moving digitally and people liking the convenience of that, here is this issue of the presence in the community. What do you mean by that?

Mr. PRICE. I think we can have the best of both worlds, digital—and I think community and banks should thrive in their communities. I think it is important we know our borrowers, our businesses. We are the number two SBA lender in western Pennsylvania, as a relatively small bank, because we are in the towns and we know the people and we are connected in the communities.

There are a lot of projects that happen in a community that wouldn't happen without that knowledge in a community. For example, we just did a drug and alcohol facility in a small town. We raised the money with local businessmen as seed money. We encouraged, coached, and counseled the leadership team. Two community banks came together to fund that enterprise; it's been up 2 years, it is very successful. It was coordinated with the public sector, public officials, businesses, healthcare.

Those are the kinds of things that happen with hospitals and retirement facilities that community banks and banks and others are at the vortex of, I just think are really important, and make a difference in the economic vitality and the growth of those places, and their livability. And I am proud to say that we do that. And it is fun, too.

Mr. ROTHFUS. You also talked about bank/fintech partnerships and the mutually beneficial relationships that traditional banks and startups can develop. Can you describe some of the partnerships that First Commonwealth has with fintech companies today?

Mr. PRICE. Yes, we do a lot, quite frankly, through our core technology provider who forges those partnerships on our behalf. Bigger banks buy fintech companies, smaller banks necessarily can't, but we can still have access to them through our core provider, and there are three or four large core providers.

Mr. ROTHFUS. So you don't see an option for a bank of your size to purchase a fintech company?

Mr. PRICE. No. And that puts us a little bit behind the starting line, there is no doubt.

Mr. ROTHFUS. Mr. Harrison, in your testimony, you encouraged partnerships between banks and fintech companies. How do these partnerships help the firms serve more consumers?

Mr. HARRISON. Thank you, Congressman, for that question. I think in the case of Elevate, we have spent the last decade ensembling lots of different types of data to make sure that we can reach a broader group of customers. Traditionally there are customers, such as Experian and Clarity that have actually partnered together to make sure that they understand where customers are actually spending their money or borrowing money from. And we can take that information and get a more holistic view of where our customers are actually lending or getting money from.

We then take that information and we provide it to banking institutions to show them that there is a different way of actually underwriting, there is a different way of reaching those customers, and that there are people that are actually invisible to the mainstream credit profiles today that absolutely are disenfranchised and live in banking deserts and that can't reach a community banking institution that we can start to find for them.

Mr. ROTHFUS. If we can follow up on that because I know the Ranking Member was bringing this issue of reaching out and serving those under-banked minority communities. I want to talk a little bit about the how. How can this work? How can fintech help to provide services to more minority borrowers who are currently under-banked? How does that process go?

Mr. HARRISON. I think Mr. Price actually hit the nail on the head that the community banking institutions are still a trusted entity within their community, and I think that we would like to—

Mr. ROTHFUS. But if there is a community that doesn't have an institution?

Mr. HARRISON. Yes. That is absolutely correct.

Mr. ROTHFUS. How can that be leveraged to reach those folks?

Mr. HARRISON. Through our technology platforms. They do a lot of online platforms that allow customers to find us over the internet, and we have been able to reach a number of different customers that do live in areas that are typically considered to be geographically bank deserts. We are going into those communities that, probably more predominantly, have check-cashers and payday lenders in their community, and we can take them away from those because we can provide a better alternative solution and a much more cost effective and safe product for them.

Mr. ROTHFUS. Thank you. I yield back.

Chairman LUETKEMEYER. The gentleman yields back. With that, we go to the gentleman from Texas, Mr. Green, who is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I thank the witnesses for appearing as well. If I may, I would like to start with the notion that the OCC (Office of the Comptroller of the Currency) may be accepting applications for a fintech special purpose national bank charter. And I am concerned about this because, obviously, there may be some predators out there who can see opportunities. I am also concerned about how this will impact the CRA.

As you know, there are moves afoot to revise, reform, somehow amend the CRA. So let me start with you, Mr. Astrada, would you kindly give me some indication as to the concerns with predatory lending as well as the impact on the CRA? And I am going to give you about 2 minutes to do it because I have another question.

Mr. ASTRADA. Thank you. I will be quick. Thank you for that question. And the OCC fintech charter really is a big concern of ours in terms of the written testimony I submitted, and the preemption of State usury caps is one of the best protections we have seen against predatory lenders. And I think what we have to step back and realize is that 10 years ago it was a research question that payday loans were bad. That is no longer an argument. That is settled. And I think it is settled in academia, it is settled on wide slots of the industry.

What happened, that evolved with fintech into high cost lenders migrating to online saying, Well, we are not payday lenders, we are different. Or simply relying on a consumer choice theory that individuals should be free to choose whatever they want. CRL has serious issues with both of these, and I will spend time on the former, is that the bank partnership model is not what we are here to argue about. What we are here to argue about is explicit preemption of State interest rates across the whole country that has shown—a model that has shown—

Mr. GREEN. One minute left.

Mr. ASTRADA. You can't separate substance from form. So this bank partnership, for decades, has shown a propensity to be taken advantage of by unscrupulous lenders. Even more so in the fintech space. Under previous regulators, it was shut down in the 2000's, but we have seen this spring up again and again with many lenders, and this is an unequivocal loophole for these lenders to hijack whatever the explicit intention of the OCC is to provide financial inclusion. Without addressing the State preemption issue—without addressing the reality that this partnership model has clear openings for predatory loans, it is ill-advised and we strongly opposed the move.

Mr. GREEN. The CRA, quickly.

Mr. ASTRADA. CRA, I think, is directly related to this in terms of using financial innovation as a narrative to say why CRA is broken. It is not. It has continued to be one of the main drivers of equity. It can be a straightforward update when you talk about innovation of product delivery rather than product itself.

So what I mean by that is that creating some type of national market with no assessment zones and decoupling the fundamental connection of race and the point of CRA, which is well-established in the legislative history, you turn the CRA into some market base incentive plan instead of an accountability law of civil rights and inclusion of what it was meant to be. I think some of the proposals coming from the comptroller fundamentally move very far away from what CRA was intended, under a narrative of the need for fintech innovation.

Mr. GREEN. Thank you very much. Mr. Rubinstein let's talk about data protection, and I am concerned about data protection from hackers as well as attackers. The hackers are the folk who would want to have some personal gain as a result of their dirty deeds. But the attackers can be nation states who want to disrupt economies, who want to sow the seeds of discord within a society.

So the question for you is, how do we protect ourselves from hackers as well as attackers, given that we have had some unfortunate circumstances with voting in the United States, questions about Russian intrusion into an election? Help me, please. You only have 20 seconds to do it, I apologize.

Mr. RUBINSTEIN. Congressman, that is a big question that we work on every day. At Fidelity, we employ every modern technique we can. Plus, we have a group focused on emerging techniques, but we do fight off hackers and attackers on a regular basis. Our job is protecting those assets, which is why we are so concerned about other firms that have access to things like IDs and passwords, or access to the customers—access to their site, that we need to protect against every different type of attack. We can certainly follow up with you afterwards.

Mr. GREEN. Thank you very much. Thank you for the extra 18 seconds, Mr. Chairman.

Chairman LUETKEMEYER. Thank you, gentlemen. Your time is expired. With that, we go to the gentleman from Kentucky, Mr. Barr, you are recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman. Mr. Harrison, I wanted to ask you a little bit more about how fintech partners with community banks and in rural Kentucky, we have a lot of community banks, but maybe not as much fintech. But explain a little bit more how fintech companies can expand access to financial services in rural America?

Mr. HARRISON. Thank you for the question, Congressman Barr. I believe Elevate, in particular, has a unique way of actually approaching our customers to evaluate what the actual need is, and we would love to be able to partner with more community banks to design different types of products. I think that our prowess in technology, coupled with the high-tech environment and the really more intuitive understanding of the customer from the community banking institutions will help to marry together much more efficient and much safer and more relevant products that can actually help us to reach broader communities also.

Mr. BARR. We continue to hear that the Modernizing Credit Opportunities Act, the true lender solution, and the valid-when-made legislation, are critical in terms of removing the impediments to expanding and amplifying the fintech community bank relationships. Can you explain—and, obviously, we recognize that the Treasury Department has made those recommendations to get those solutions into permanent law. Can you explain to me how those solutions would expand access to more services and products?

Mr. HARRISON. Absolutely. I think that community banks in general have been hesitant to engage completely with a lot of fintech companies because of the lack of regulatory clarity. I think with that type of clarity and continuous to have conversation and dialog around those regulations that fintech companies will absolutely step up to the plate and make sure that we are in compliance with all of those and make sure that we assist the banking in keeping their good rapport with the bank examiners and the regulators as well.

Mr. BARR. Mr. Price, can you comment on the question, tell us why the true lender and the valid-when-made, the solutions, would be helpful, or how would that change the landscape?

Mr. PRICE. Thank you for the question, Congressman. I think what fintechs can bring to the table sometimes is edges of innovation in ways of doing things. Now, those things have to prove themselves out through the next cycle, and I have been through three or four of those. I am sure they are mindful of that. But I struggle sometimes, we, probably 3 or 4 years ago, we met with probably the top five alternative lenders in the company, and they weren't that interested in talking to us. They came back to us a few years later very interested in using our balance sheet, but they still own the customer.

So what we have done, quite frankly, is we have developed our own online lending capability and deposit gathering capability. We will continue, and I am sure we will have some partnerships, we certainly have it with fintech companies in other disciplines, whether it is personal financial management tools, et cetera, but lending, we just haven't struck a cord yet.

Mr. BARR. On this question of greater harmonization and uniformity, can—Mr. Astrada, I was struggling a little bit with your testimony. Can you explain why you are so averse to better harmonization and uniformity?

Mr. ASTRADA. Yes, it is not so much that we are opposed as the legislative affect that this would have on consumer lending. I think taking an expansive view of predatory lending, the difference between getting an 800 percent APR loan and a 90 percent APR loan nominally is a plus. But when you look at the consumer protection issues of State preemption, when you look at, no matter whether you default in a 90 percent loan or a 100 percent loan or a 300 percent loan, the impacts of that default are real. So it is a question of affordability. It is a question of ability to repay and it is a question of underwriting.

So what these bills would do on the true lender aspect would be ignore what seems to be called friction in the industry as a legal tool to root out sham lending.

Mr. BARR. If we did an OCC charter, it would be optional. In other words, it wouldn't be a mandatory preemption, it would be optional, to access a Federal uniform interstate harmonization. So it wouldn't necessarily preempt State consumer protection laws?

Mr. ASTRADA. Oh, I thought you were referring to the valid-when-made in true lender bills, not the OCC charter. That is a semantic difference for us, but a real one. But I think the legal theory behind the true lender bill would ignore economic reality in favor of fiction of just who is on the dotted line, and that comes at the expense of a legal tool that has historically been very effective in rooting out sham partnerships. On the valid-when-made aspect, I think the legal theories that the bill relies on, and I borrow this analysis from Professor Adam Leviton, is incorrect, that there is no longstanding valid-when-made doctrine. The National Bank Act wasn't passed until 1864. That in his research, he found no cases that deal with these various assignments until the late 20th century. So the Nichols case that the bill relies upon, I think, is an overreach in terms of the conclusion of defining the problem that the bill seeks to solve, and the consumer impact reality of what that bill would do would, one, rob the legal system of calling out and investigating sham partnerships, and on the valid-when-made, create a great benefit for secondary market securitization, but at the cost of unaffordable lenders taking a very expansive view of what predatory loans are for the consumer. Sorry for going over.

Chairman LUETKEMEYER. The gentleman's time has expired. With that, we go to the gentlelady from New York, Ms. Tenney, is recognized for 5 minutes.

Ms. TENNEY. Thank you, Mr. Chairman. I thank the panel for being here today, it is an interesting topic. I first wanted to address my questions to Mr. Harrison. You mentioned the term "banking deserts," and I represent central New York, upstate New York, and we have a lot of bank deserts. I have an entire town that doesn't even have a bank, they have to go to an ATM. We have a lot of small community banks that have been lost, a couple have been preserved, especially thanks to the latest reform that we did to give them a little bit of a break on a number of issues, especially the Dodd-Frank reform bill that we recently passed, 2155. But we still have an issue where—I met with a number of the community banks, and they were concerned—when they talk about fintech—they are concerned that there is somehow a person behind a computer and they don't really know the face or the name. I am curious about the possibility, and I am open-minded about the possibility. If you could just explain a little bit about the rural maybe—and possibly even in urban areas, although I have smaller urban areas—how fintech can partner in a way with community banks that is transparent, that gives people the confidence they have in their hometown community bank. If you can just give me a quick way that you think, maybe 1, 2, 3, what the best ways you can do that are?

Mr. HARRISON. Sure. Thank you for the question. I think that where we can enable different types of technology to reach customers in those rural areas is really by using online resources, and being able to partner with the banking institutions in community areas to find out how do we get to those customers? I think that we have been able to really go into communities that are, again, predominantly with payday lenders, and we have been able to bring those customers back away from there and understand that they can access a lending platform through their mobile phone over the internet in a lot of different ways and be able to get fast decisions that they don't have to wait for long periods of time in order to know when they have been approved or not.

We have been able to save customers over $4 billion as an alternative payday product. We believe that we can get even better than that as we continue to reach out to those customers.

Ms. TENNEY. Yes. Can you just get a little more specific? You say we can get to the customers. How do you actually get to the customers, because these are presumably the bank's customers?

Mr. HARRISON. They are.

Ms. TENNEY. How do you work with the bank and partner with them so they don't lose their customer base, so they are not obliterated by some of these huge banks that come in and, they are on an 800 number—my bank, I can walk in—it is a lovely little community bank, it has been around for over 100 years. I can still walk in and hand my checkbook to the note teller, and she balances my checkbook while I go and talk to the bank president. It is that close community feel that I know that I can trust them. But what do you actually do? Do you partner with the bank to reach the customers?

Mr. HARRISON. Yes.

Ms. TENNEY. What is your marketing plan to get to them?

Mr. HARRISON. So we have talked to bank presidents that have actually told you us, I have customers that have a checking account with me that have a 500 FICO score, but they don't qualify for any lending product that I have because the lowest that I can go is 700 for their lending products.

What we have been able to do is talk to them about what is the actual need. A lot of times, they will tell us that they are short-term loan products, which is within our wheelhouse to do. So we will absolutely partner with them to market to them through either direct mail, or we can actually create programs that market directly through the banking institution itself.

Ms. TENNEY. So how do you actually provide the service? It is like a service for the bank in the partnership? So you would say, we are going to provide you some—save you cost to the bank, for example, a small community bank on online—how do you partner with them in a regulatory environment, like say, New York, where it is very difficult to do anything, let alone partner as an outside company, an outside financial institution trying to work within maybe a community bank atmosphere to help them with their online presence? I don't mean to get into the details too much, but how do you share profits? How do you make a decision about whether a loan is going to be made or not? Does the community bank make that? Who bears the liability? Does the fintech company bear the liability, or does the small community bank?

Mr. HARRISON. The bank is always absolutely the lender in these business ventures, and we are simply a service provider to them. We help to enable them to do this outreach to their customers through a lot of different channels. We look at what they are currently doing, and then we talk to them about what are the ways that we can more cost effectively outreach to those customers. We have a lot of infrastructure ourselves. We are a huge direct mail marketer—

Ms. TENNEY. Do you have any of these partnerships with community banks right now?

Mr. HARRISON. Yes, we do.

Ms. TENNEY. You do?

Mr. HARRISON. Yes. We have a couple of bank partnerships, one in Provo, Utah, one is Louisville, Kentucky, where we have partnered with the community banks to actually help them to enable a national product.

Ms. TENNEY. Thank you very much, appreciate it. I think I am out of time. Thanks so much.

Mr. HARRISON. Thank you.

Chairman LUETKEMEYER. The gentlelady's time has expired. With that, we go to the gentleman from Georgia, Mr. Loudermilk.

Mr. LOUDERMILK. Thank you very much, Mr. Chairman. I thank everyone on the panel for being here today. Look, as spending over 20 years in the technology sector, finding ways to use technology effectively, efficiently, and securely, to improve our quality of life, to improve efficiency in business is extremely important to me. Fintech is also extremely in my district. Georgia is a home of fintech where 70 percent of our Nation's payment processing is done. We are also considered the Silicon Valley of the south, a lot of startup businesses beginning in Georgia. Our legislature—working with our legislature to make sure that we are doing the right things to keep those businesses in Georgia as well. I am very excited about a lot of what we are doing.

But from a cybersecurity aspect, I do have some concerns. That is one thing we have been working on as a committee is the patchwork of standards that we have currently regarding data security, protecting personal privacy, et cetera. Our committee just passed a bill of couple weeks ago that would help with that.

So my questions are going to be around this area, as far as a regulatory area regarding cybersecurity, et cetera. First question, Mr. Price, why is it so important for consumers in different States to have the same expectations and data security standards that their bank or credit union must adhere to?

Mr. PRICE. I think because lending people money or taking deposits is serious business. A new house, an education, a car, these are seminal moments in people's lives, and these decisions demand people's attention and a lot of carefulness and thoughtfulness on our part as well.

The other thing I would add is, as a bank, we are subject to something called FFIEC (Federal Financial Institutions Examination Council) guidance, it is part of the regulatory standard, it is four or five standards, it includes everything from tabletop exercises, ethical hacking, phishing exercises, are all part of evolving our defense continually when it comes to securing data and protecting customers. I do think the standard is higher for community banks than it is for our fintech partners. I think they have more of a reactive regulatory framework with FTC in a safeguard-type of approach. My comments earlier were I think the playing field should be level, and I think that is fair.

Mr. LOUDERMILK. To follow up on that, what are the compliance challenges that the industry faces with the patchwork of sometimes conflicting data security and breach notification laws?

Mr. PRICE. I can't speak specifically to that other than to say, in general, we have gone from 14,000 to about 6,000 community banks. That is not the answer to banking deserts. I think regulation has—the bar has been raised. We got some recent relief—thank you—but I think the regulation needs to be consistent, from fintech to bank to big bank, community bank, and appropriately tailored, if you will.

Mr. LOUDERMILK. OK. I appreciate that. I have had some in the financial services sector come to me and complain that if I am in compliance in one area I am out of compliance in another, just because of the conflicting nature of these. So I appreciate that.

Mr. Rubinstein, I understand your company is developing innovative new ways to protect your customers' data when they use third-party data aggregators by eliminating the need to copy usernames and passwords onto third-party platform. Can you just elaborate how that works?

Mr. RUBINSTEIN. Yes, Congressman, thank you. It is not only our company. The industry is moving in this direction. So data sharing has been going on since the mid 1990's. The cybersecurity environment, as we all know, has changed dramatically. So what we are doing is we are working with fintechs, with aggregators, and with banks and brokerage firms, platform providers, the core providers that Mr. Price referenced, in ways for consumers to actually affirmatively instruct their institutions.

So basically log into their institution and say yes, please share my data with this third party. So they go through the authentication not with the fintech, but they go through it with their institution. What that does is that permits their institution, one, to set up a secure connection; two, to help the consumer monitor that on an ongoing basis so the consumer doesn't use an app and forget, meanwhile the data is still being harvested; and third, it provides a way for the consumer to go to the institution and say, I don't want to use it anymore, and revoke that consent.

Mr. LOUDERMILK. OK. Thank you. This is the type of innovative thinking that is very beneficial to the industry.

Mr. Chairman, thank you for the time and I yield back.

Chairman LUETKEMEYER. The gentleman's time has expired.

Now we go to the gentleman from Colorado. Mr. Tipton is recognized for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman. I apologize. I was running late. I had another meeting to be able to be at.

But, Mr. Harrison, I wanted to address you maybe first. I represent rural Colorado. I have a lot of small communities, a lot of underbanked communities and a lot of innovations. To make sure that we have a fair and level playing field for these rural communities and the underbanked to be able to participate is incredibly important for us.

Can you maybe expand for me at least how your business—why you deal with the banks and how this is going to be benefiting some of these rural communities, why that is important?

Mr. HARRISON. Sure. Thank you for the question, Congressman Tipton. Again, I believe that our partnerships with banks give us a better insight to what consumers actually need. I think that banks have attempted to serve their customers in a way that we are just evolving to really understand. Although I will say that we take a very customer-centric approach to the design of all our products, where we start with what has the customer actually asked you for and how do we best anticipate their needs in the future so that we are not just a part of an immediate need, but also what is the life cycle of that financial life after we go through that. So we will work with our bank partners to actually create these products and then also help to enable them as their service provider.

Mr. TIPTON. One of the issues I really hear, Mr. Harrison, at home from a lot of our small community banks in particular is they would like to be able to do something, but regulatorily they are inhibited from doing something.

Are there any regulations maybe that you can point to that are inhibiting you from being able to work with some of these small community banks?

Mr. HARRISON. I think true lender. The true lender rule I think is the one inhibitor that would help us to provide some clarity and establish the bank as the true lender. We are absolutely ready to engage in any dialog that is necessary in order to clarify what that truly looks like from a practical business perspective.

I think that a model that Elevate has actually established with our banking partners is one that actually we can use as a proxy to better inform and refine that for the entire industry.

Mr. TIPTON. I have the Treasury report. Is there anything in particular that you could maybe point to that might be able to help Elevate or any other companies to be able to reach out?

Mr. HARRISON. I am not as familiar with the Treasury report as that is more recent to me, but I would be happy to go back and look at that and get back to you on that for sure.

Mr. TIPTON. Great. Thank you so much, I appreciate that.

Mr. Rubinstein, great to see another Rubinstein up here and glad to have you here. Can you maybe detail briefly what work and benefits that you've been working on have yielded really to our consumers?

Mr. RUBINSTEIN. Congressman, thank you for that question. The work we are doing is really to protect consumers. We have 30 million consumers, $7.3 trillion in assets that we need to protect. So it is all about protecting consumers from insider threats, from individual hackers, and from nation-state attacks. It is not only protecting them when they are at Fidelity, but it is helping to protect them when they decide to use some other service where they connect their Fidelity account or in the larger world connect any institutional account.

So we believe that we are trying to move to a space where consumers understand how their data is being used when they share it, that they are able to monitor that on an ongoing basis and able to revoke that consent.

I've given a few talks on this topic. I also often ask people, do you use this personal finance app? Some people say, yes, I used to use it. So I said, well, what did you do to stop using it? The number one answer is, I stopped using it; and the number two answer is, I deleted the app from my phone. Neither one of those two things actually stops the harvesting of consumer data every day.

If we can change the way consumers authenticate and the way they control that flow, we can put the control back in the hands of the consumer so they know how their data is being used and they can revoke that consent at any time.

Mr. TIPTON. What exactly can consumers do? That would be my response; I just delete the app. But—

Mr. RUBINSTEIN. So today consumers have to remember all the different apps that they use, then go into those apps and actually request for it to be deleted and request for their data harvesting to stop. They could change their password on all their financial institution sites. That is a hardship and then people don't remember the new password, or we could just flip the model upside-down so that they can get a dashboard at their financial institution, whether at their bank, their brokerage firm or wherever, where they can have that dashboard, see what is going on, and be able to push a button and revoke access.

Mr. TIPTON. Great. Thanks so much.

Mr. Chairman, my time has expired.

Chairman LUETKEMEYER. The gentleman's time has expired.

With that, we go to the gentleman from North Carolina. Mr. Pittenger is recognized for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman. I appreciate it. Thank each of you for being here with us today.

Mr. Cutler, regarding data sharing, as it plays a major role on the international stage, are there international standards or procedures that you would recommend or drawbacks that you would see relative to what can be done in our own U.S. financial system?

Mr. CUTLER. Absolutely, sir. In my written testimony, I reference several times the U.K. and their standards. I think we should look to what the U.K. is doing in the Financial Conduct Authority, FCA, as a good model for what we should look to. I think in the Treasury report they point to that model several times. So I think we should look there.

Mr. TIPTON. Thank you. The Treasury report calls for greater harmonization among State regulators for licensing requirements. To that end, since many fintech companies are subject to these State regulators, are varying licensing requirements between States impacting the ability of fintech companies to provide new product innovation?

Mr. CUTLER. I think that, Congressman, that is a great question. I think there needs to be more State harmonization. It is a real hindrance right now. It is an expense for fintech companies to apply for these State licenses that are very similar but also different.

So they have to go through the process. They have to apply. They have to pay the fees. It is very time-intensive, resource-intensive. If there was a streamlined process, it would save a lot of resources.

Mr. TIPTON. Thank you. So, Mr. Price, your testimony discusses the importance of partnerships between the banks and the tech companies. To that end, does the current regulatory scheme hurt banking innovation?

Mr. PRICE. I think to the extent that there is not a level playing field, it does. I will just give you one example in payments. If you are a fintech, if you are Square, you can put in a touchpad and you can get into your account. If you are a bank, you can't do that. So that is just one example. So the playing field is not level between banks and fintech companies.

Mr. TIPTON. To that end, what change would you recommend to encourage innovation?

Mr. PRICE. I think a level playing field between banks and fintech companies. If you are in the banking business, you have regulatory oversight, CRA, HMDA, Fair Lending. If those regulations need to be modified or changed, we can do that. But it should be the same for anybody who makes a loan or takes a deposit.

Mr. TIPTON. Thank you. To each of you, I would ask, cybersecurity, of course, is one of the most important issues facing companies of all kinds, especially in the wake of the Equifax breach. What steps do banks take to protect personally identifiable information, private and financial data? Who would like to answer that?

Mr. PRICE. We have, as I mentioned earlier, FFIEC guidance, which is regulatory guidance. We do everything from tabletop exercises, ethical hacking, phishing exercises. Our enterprise risk culture around this is evolving constantly. We get regulated on it every year by the State, Federal Reserve, and the FDIC. That is incredibly important to us.

Mr. TIPTON. Thank you. Mr. Rubinstein, did you want to say something?

Mr. RUBINSTEIN. Congressman, this is an area of extreme concern for us. It is the number one thing we focus on. As a large institution, we have over 700 people who are focused specifically on cybersecurity.

We get attacks just about every day. We fend those off. It is an ever-escalating battle of firms like ours employing new tools because the bad guys are employing new tools. One of the reasons we are so passionate about data aggregation and changing the model is we often find criminals take user IDs and passwords that they find on other sites.

So yes, we have all heard about big hacks that have happened at low-risk sites. They take those credentials, they go open an account at a fintech impersonating that customer. They use those, log into a bank or a brokerage firm. They find valid ones, and then they use those as a means to attack. So we have to defend against that as well. It is an ever-escalating battle that we are extremely focused on.

Mr. TIPTON. Thank you. My time has expired.

Chairman LUETKEMEYER. We have a couple of follow up questions here for some members, so we will start with Mr. Barr for a second round. Thank you.

Mr. BARR. Yes, thank you, Mr. Chairman, for the follow up.

Mr. Cutler and Mr. Harrison, you heard my question and Mr. Astrada's answer and his defense of the State-by-State regulatory model here and the applicability of State usury laws.

Mr. Cutler specifically, to give you an opportunity to maybe respond to that, given your testimony here today in defense of a clarification of true lender and valid-when-made doctrine, and I just invite you to respond to his testimony if there is a counterpoint.

Mr. CUTLER. Thank you, Congressman Barr. In my opinion, a handful of court decisions have wrongly called into question whether the bank is the true lender in a bank-fintech company partnership. These court decisions are based on a predominant economic interest test that is subjective and that can be cited to conclude that the fintech company is the true lender in these circumstances. Whether the bank or fintech company is the true lender may be the difference in determining whether a loan is void or uncollectible.

I think personally that the uncertainty is having a chilling effect on innovation here. So I think it is important to address this uncertainty, and I think the legislation that has been passed has been helpful and it will be important to go forward on that and get signed into public law.

Mr. BARR. What would be the argument to restrict the transferability of loans? What is the argument in favor of that?

Mr. CUTLER. I don't see it. When I first started my career, I was in the securitization business. When we were in that business, it is clear that the rights in the loan followed when you transfer it. So it doesn't make sense to me.

Mr. BARR. Mr. Harrison, can you chime in on this issue?

Mr. HARRISON. Yes, absolutely. I support Mr. Cutler's responses. I believe that support for clarification on true lender and also support on valid when made is substantiated.

I don't believe that there is any intent from the fintech world, to harm our customers in any way in particular. I think that, again, we will abide by regulations as our banking partnerships dictate, and we will continue to try to do everything that we can to protect our customers.

Mr. BARR. If Congress does not clarify this issue, tell me about the impact on innovation. What will be the impact on innovation if there continues to be this uncertainty in the legal world on the transferability of loans?

Mr. HARRISON. As much success as a company like mine, Elevate has had, there are still 160 million Americans that have credit scores that are below 700. We have been able to serve a couple million of those, so we are only really scratching the surface.

The reality is that these bank partnerships with fintech can help us to enable another multiple of us being able to reach out to those customers and be able to understand what needs do they actually have so that we can design better and safer products for them in the future.

Mr. BARR. In States where, in rural America, like my district, where you don't have access to fintech and you don't have access maybe, and if bank-fintech relationships are not allowed to flourish, what does that mean? Does it mean more bankruptcies? Does it mean more overdrafts? What is the impact on those underserved borrowers?

Mr. HARRISON. Yes, I think it does from a macro level. But from a micro level, we look at the impact to the customers every day. We have customers that don't have the money that they need for medical expenses. They don't have the needs that they have for home repairs, for car repairs. These customers that are in these rural areas, not only do they not have access to banking institutions sometimes, but they also don't have immediate access to food or to just basic needs that they have in order to continue their life.

So having that outreach and enabling them and giving them the resources that they need to maintain their lifestyle is a huge impact from a practical perspective.

Mr. BARR. I really appreciate all the testimony today. I think fintech is a huge opportunity for American consumers, particularly underbanked consumers, people who live in economically distressed places, and rural America.

And I think Congress does need to start getting serious about creating a legal landscape that allows these relationships to flourish so that underserved populations can have access to these very innovative products.

Thank you, and I yield back.

Chairman LUETKEMEYER. The gentleman yields back.

I have just a couple of follow ups, Mr. Astrada.

Mr. ASTRADA. Can I just request 30 seconds to answer the Congressman's question of why you would restrict it? I just think it is just really core to this.

Mr. BARR. Sure.

Mr. ASTRADA. I don't want to restate the point, but I think one of the best reasons to restrict the transfer of loans is when the very model itself has been hijacked by unscrupulous lenders. And I know we can talk about intent, but if you look at page 6 of my testimony, it is not about intent or subjectivity. Like, the default rate on the securitization of marketplace loans has skyrocketed in the last year and a half.

So whether there is an intent to harm or not, the consumers are bearing the risk of those failed loans, and marketplace lenders are able to pass it off on the secondary market. And there are the cases that some of these marketplace lenders, really big ones, some that you hear from every day, their defaults are in the double digits. Their default rates are close to 50. They are underwriting, they are passing the risk for failure to the consumer and the cost to the investor.

So that is why we are so adamant about restricting the transfer of loans in this model. Thank you for the extra time.

Chairman LUETKEMEYER. I have a couple of follow up questions. Mr. Rubinstein, you have talked a lot about the control of data. And I would just like to get on record who actually owns the data? Do you own the data? Does the consumer own the data? Whenever they give control to you by signing it away, have they given up control of it? Give us exactly where this all sets so we know, because we have to build on that very premise and that information to be able to understand what we are doing here.

Mr. RUBINSTEIN. Congressman, we come from the very straightforward place that the consumer should be able to share that data as they see fit.

Chairman LUETKEMEYER. Is there something in law? Is there a legal basis for the consumer owning his data somewhere?

Mr. RUBINSTEIN. I am not a lawyer so I apologize. I actually don't know if there is a basis in law. But we take the perspective that the consumer should have access. And I think Section 1033 of Dodd-Frank calls for the consumer to have even electronic access. We do think the consumer should have access as well as be able to use that data in a safe, secure, and transparent way when they want to use it.

So if they want to use it with a lending application or if they want to use it with a budgeting application or anything else, they should have that ability, but they should also know what they are getting into. That data should be used at the other side for the purpose the consumer thought it was. If they think they are using a budgeting app, they should get a budgeting app. It shouldn't be that it is a Trojan horse for the gathering, accumulating, and reselling of that data. Perhaps if the consumer wants to permit it for that purpose, the consumer should be able to permit it for that purpose, but they should know that is happening.

We think that burying something on page 35 of a privacy policy doesn't help the consumer understand how that is being used, and we need to see more explicit consent from the consumer for how that data is used and, again, give them the right to revoke that consent at any time.

Chairman LUETKEMEYER. Very good.

Mr. Cutler, one of the concerns I have is that with fintech companies, a lot of them are startups, a lot of them are pretty thinly capitalized, and to me there would seem to be a risk there from the standpoint that if the economy turns down or there is a bump in the road or their business model isn't quite right that something can happen.

Would you agree with that? Is there a risk there? Are they all in good shape? To me, for the fintech guys to partner with the financial institution at some point would seem to be a good idea from the standpoint of securitizing their future there with some balance sheet strength. Would you like to comment?

Mr. CUTLER. Thank you, Mr. Chairman, for the question. I think both options are great. I think partnerships with the big banks and all banks and community banks should be encouraged, and those can be very beneficial. But I think we also want to encourage folks with an idea in a garage to start a new business, and if it has little capital but a great idea, we should do everything in our power to give them the tools to succeed.

Chairman LUETKEMEYER. Mr. Harrison, I think you mentioned that 700 seems to be a magic number for the credit score or for folks that you want to deal with. I saw an article in the paper this week that the new average for people in this country is now I think 704, 706, somewhere in that neighborhood.

Mr. HARRISON. Yes, sir.

Chairman LUETKEMEYER. So if that is the average credit score, which is the highest in history, that means half the people in this country couldn't qualify for stuff that you are talking about. Is that right?

Mr. HARRISON. That is exactly right. A little bit over half of the population of the U.S. today does not qualify for mainstream products. And that is another reason why outreach to some of the community banks and being able to help them to design products that are safe and secure for their constituency is really important.

We want to be able to design even more products. We want to be able to leverage the fact that community banks and also just banking institutions in general have a lower cost of capital, which is really a lot of their prowess and their understanding of the regulations and their oversight, help us to make sure that we are doing this in a safe and secure manner.

So we will absolutely continue to pursue these partnerships with banking institutions, because we believe it is the right balance that we can have from the best of both worlds.

Chairman LUETKEMEYER. Mr. Price, would you like to comment on that?

Mr. PRICE. I think the challenge as we have tried to forge these partnerships initially was whose customer is it? And if it is our customer and we have the checking account, the debit account, the credit card, small business loan, and we are doing an alternative lending product, we think it is our customer. And that has been the flash point.

And, quite frankly, I think we will forge through that over the next half decade or so, and we will get to something we can both live with, their business model and ours. That is helpful.

Mr. HARRISON. And I agree with Mr. Price. It is the bank's customer for sure.

Chairman LUETKEMEYER. Very good. Thank all of you today for your fantastic testimony. I feel like the Maytag repairman here, the loneliest man in town. So it is probably time to go home. So, again, thank you for your testimony.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And, with that, this hearing is adjourned.

[Whereupon, at 10:34 a.m., the subcommittee was adjourned.]

A P P E N D I X

September 28, 2018

CRL
Center for Responsible Lending

Testimony of Mr. Scott B. Astrada

Director of Federal Advocacy,
Center for Responsible Lending

Before the U.S. House Committee on Financial Services'
Subcommittee on Financial Institutions and Consumer Credit

Examining Opportunities for Financial Markets in the Digital Era

September 28, 2018

Good afternoon Chairman Luetkemeyer, Ranking Member Clay, and Members of the House Committee on Financial Services' Subcommittee on Financial Institutions and Consumer Credit. Thank you for inviting me to testify today about opportunities and challenges posed by financial technology (fintech) in the financial services marketplace, the current regulatory and consumer protection landscape, and the need to ensure that emerging products and players best serve consumers rather than trapping them in unaffordable or abusive debt.

I am the Director of Federal Advocacy at the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution. For thirty years, Self-Help has focused on creating asset building opportunities for low-income, rural, women-headed, and minority families. In total, Self-Help has provided over $6 billion in financing to 70,000 homebuyers, small businesses, and nonprofits and currently serves more than 80,000 mostly low and moderate-income families through 30 retail credit union branches in North Carolina, California, and Illinois.

This important hearing addresses how technological innovation has resulted in the development of new services and delivery platforms by both traditional financial institutions and non-bank fintech companies. The rapid expansion of market participants and their products has brought new opportunities, as well as significant consumer protection concerns, to the financial marketplace. In my written testimony I will discuss in detail the essential legal questions and consumer protection issues that must be at the center of the broader fintech dialogues occurring between consumer groups, lenders, regulators, and Congress. My testimony will address two main topics. In Section I, I will broadly identify some of the key consumer protection concerns that have emerged with the rise of fintech marketplace lending (one of the fastest growing components of fintech). In Section II, I will focus on the United States Department of the Treasury's report released on July 31, 2018, titled *A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation*.[1] Referencing the report, I will discuss areas where CRL, along with numerous civil rights groups and state attorneys general, have expressed significant concerns about the impact that the Treasury Report's recommendations would have on

[1] U.S. Department of the Treasury, Report to President Trump: A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation (July 2018), [hereinafter, Treasury Report] available at https://home.treasury.gov/sites/default/files/2018-07/A-Financial-Systemthat-Creates-Economic-Opportunities---Nonbank-Financi....pdf.

consumers. *Our central priorities are (1) preserving the progress made by state and federal stakeholders to guard consumers from predatory debt trap loan products, (2) ensuring fintech lending evolves in cadence with existing and developing consumer protection laws, and (3) the preservation of state usury laws.*

I. Consumer protection concerns with an emerging policy space

The term fintech, admittedly overly broad in the context of specific policy recommendations, warrants a more specific definition for the scope of my testimony. Rather than referring to a specific platform or product, fintech is best considered, as Professor Adam Levitan describes it, as a rubric that covers a broad range of companies and products: "[s]ome of these companies offer consumer credit, some payments, some insurance, some investment services, and some financial advice. Some of these companies compete directly with banks, while others partner with banks. Additionally, some fintechs deal directly with consumers, while some provide support services for other financial institutions."[2] Given the topic of this hearing and the jurisdiction of the Committee, I will use the term fintech in a narrowed definition to address consumer lending products and services (including secondary market securitization) of banks and non-bank financial institutions, as well as the relevant current and evolving consumer protection laws and guardrails.

CRL is wary of unscrupulous actors and payday lenders adopting the banner of "fintech" with the purpose of evading consumer protection laws, particularly state-level rate caps for consumer loans, while using the term "innovation" as a justification for exemption from basic, long-standing consumer protection laws and regulations. Ultimately, there is no getting around the fact that a predatory loan is a bad loan, regardless of whether it is delivered through a technically advanced medium or a storefront. However, we are well aware, and are encouraged by, the potential benefits of fintech, especially as it relates to affordability and financial inclusion. CRL is dedicated to ensuring consumer lending marketplaces are fair, transparent, and equitable, and we are appreciative of the opportunity to contribute to this discussion. We are also very concerned about specific Treasury Report recommendations that robustly address the benefits of fintech for

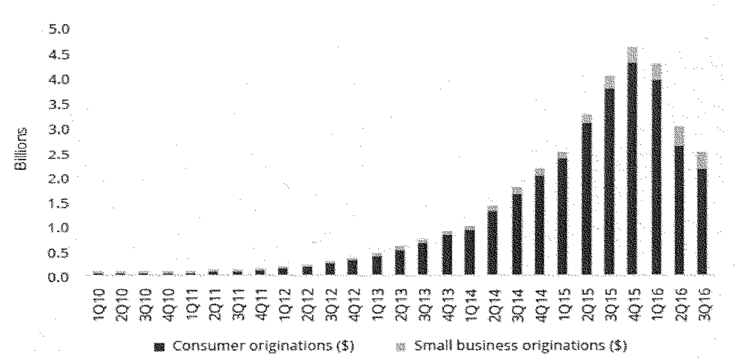
[2] Adam J. Levitin, written testimony delivered to the United States House of Representatives Committee on the Financial Services Subcommittee on Financial Institutions and Consumer Credit "Examining Opportunities and Challenges in the Financial Technology ("Fintech") Marketplace" January 30, 2018. Available at https://financialservices.house.gov/uploadedfiles/hhrg-115-ba15-wstate-alevitin-20180130.pdf

investors and professional traders, but sometimes excessively relies on an untested, and oftentimes invalidated, policy narrative about how consumers will benefit from innovation.

The Growth of Marketplace Lending

As one of the fastest areas of growth in fintech, marketplace lending, is a quickly growing market at the center of research and data modeling. As defined by the Consumer Protection Bureau, "[m]arketplace lending uses online "platforms" to connect consumers or businesses who seek to borrow money with investors willing to buy or invest in the loan. In most cases, once a loan is made, the platform collects principal and interest payments from borrowers and sends the payments, less certain fees that the platform keeps, to investors."[3] Marketplace lending is growing (see figures below), but still represents a small fraction of the overall consumer lending market, with marketplace loans "representing a small portion of the $3.5 trillion U.S. consumer lending market, the largest online marketplace platforms originated over $5.0 billion of unsecured consumer credit in 2014, and over $10.0 billion in 2015."[4]

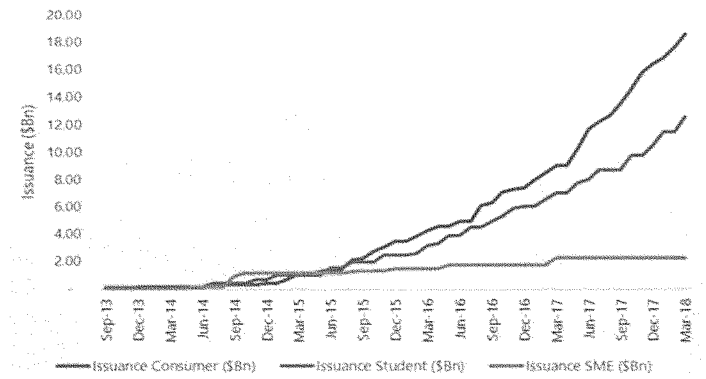
Marketplace lending originations by quarter ($ billions, cumulative total in the US 2007 to 3Q 2016 is $35.7 billion)



Source: Orchard

[3] https://files.consumerfinance.gov/f/201603_cfpb_understanding-online-marketplace-lending.pdf; See also "Online marketplace lending refers to the segment of the financial services industry that uses investment capital and data-driven online platforms to lend either directly or indirectly to consumers and small businesses."
https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf
[4] https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf page 14

Cumulative total issuance 2013 to 2018



Source: Bloomberg, PeerIQ

Marketplace lending is oftentimes touted as providing new access to credit, potentially at lower rates with streamlined underwriting. However, many questions remain — are originations truly new, or is this piled on debt that will not pay off the original loan? Who is accountable for risk and consumer harm, the online platform or the investors making the loans? Who has oversight over the investor/lenders and the platform?

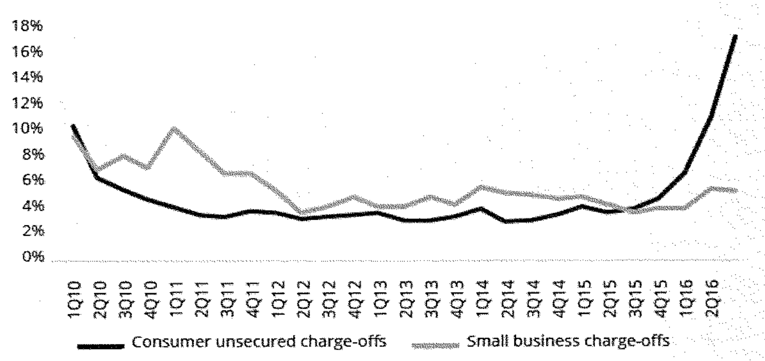
The Treasury Report cites a study by the Federal Reserve Bank of Philadelphia to support the claim that fintech is a driver of financial inclusion, pointing to specific examples such as marketplace lenders serving communities where physical bank branches have closed.[5] However, the preliminary conclusions that the report draws from examples such as these, in terms of capturing underserved populations, is that the primary purpose of many marketplace loans is to refinance higher rate debt into less expensive debt.[6] The Treasury Report's claim does not logically follow from examples of financial inclusion outside of debt refinancing, which is not "new" capital to start a business, buy a home, or build a path to a higher income through education, but is instead a service for consumers with existing debt. While cost savings are a benefit for consumers, the assertion that marketplace lending is a main driver of financial inclusion for productive uses of

[5] Treasury Report, at 89, *citing* Julapa Jagtiani and Catharine Lemieux, Fintech Lending: Financial Inclusion, Risk Pricing, and Alternative Information, Federal Reserve Bank of Philadelphia Working Paper 17-17 (2017), at 9-12, available at: https:// www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2017/wp17-17.pdf.
[6] *Id*, at 90

loan funds, rather than a driver for cost savings, warrants a distinction when we consider the reforms proposed the Treasury Report, especially when it relies on such overgeneralizations about consumer benefits from innovation to justify recommendations that would jeopardize consumer safety.

Furthermore, it is too early to tell whether marketplace lending can be productive in different economic environments, or if it is providing only a temporary service. Looking at market trends, one concerning data point is that alongside this initial explosion of growth, there are also growing signs of stress and potential market failures as evidenced by a growing number of defaults and charge offs (See figure 6 below).

Figure 6: Marketplace lending charge-offs by quarter (%)



Source: Orchard

The securitization of marketplace loans quickly increases systemic risk and expands the stakeholders of marketplace loans to include traders and asset speculators. This is where a distinction must be made between regulatory efficiency for asset speculation in the secondary markets, from innovation with the aim of financial inclusion. Fintech companies must be accountable for claims that automatically correlate regulatory flexibility with consumer benefit. While these two priorities are not mutually exclusive, they are distinct, and should not be conflated under a broad call to minimize the presence of federal regulators who are in a position to ensure consumer protection laws are enforced and effective. Securitization is not a new innovation, and 10 years out from the mortgage lending crisis we know all too well the damage done by Wall

Street-driven demand for loans with generous interest payments and poor underwriting practices. Cumulative issuance for marketplace lending securitization now totals $38.4 billion across 126 deals since 2013. Since September 2013, 80 consumer, 36 student, 10 SME, and one mortgage deals have been issued. The total issuance of securitized consumer loans is $21.2 billion, for student loans it's $14.8 billion and for small business loans $2.5 billion.[7] Delinquencies on these securitized loans are happening more frequently and earlier in the life of the loan than they did on the older loans. As we have seen in the past, securitization amplifies the risk and uncertainty in the system when the underlying assets are not sound financial products. One particularly striking example is when one lender had experienced such high net losses in three of its securitized pools that it trigged the provision to buy back the loans from its investors. These were for loans that carried APRs of 30 to 50%. The rapid growth of originations in marketplace lending, and a corresponding growth in delinquency rates, evidenced in securitized marketplace loans, is a cause for concern.

As the Treasury Report acknowledges, "with only a few years of credit performance, these credit models have yet to be tested in various macroeconomic environments that would include either higher interest rates or a general economic downturn."[8] This insight should again be a caution against ignoring consumer protections surrounding bank partnerships, the call for regulatory sandboxes, or compromising state consumer protection laws. In fact, CRL points to this very premise as to why consumer protection laws should remain intact and evolve alongside innovation. While we are all admittedly unsure of what fintech can deliver, in terms of financial inclusion, we do know for a fact what happens when consumers are left in the crosshairs of predatory lenders. Short-term payday loans and car title loans cost borrowers over $8 billion per year in fees and often lead to financial challenges, such as delinquency on other bills, overdraft fees, loss of a checking account, debt collection costs, and bankruptcy.[9] Regulators should refocus the discussion of marketplace lending around streamlined underwriting and ability-to-repay and underwriting requirements in order to ensure these products are sound, and reasonably priced in accordance with state laws.

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[7] Ahluwalia, Ram, Kevin Walsh, and Sam Hu. "Marketplace Lending Securitization Tracker." PeerIQ, 2Q2018. https://www.peeriq.com/research/peeriq-mpl-securitization-tracker-2018-q2/.
[8] *Id*, at 90
[9] See Center for Responsible Lending policy brief, *Neglect and Inaction An Analysis of Federal Banking Regulators' Failure to Enforce Consumer Protections* (2009). Available at http://www.responsiblelending.org/mortgage-lending/policy-legislation/regulators/neglect-and-inaction-7-10-09-final.pdf

Who Bears the Cost of Failed Loans?

A recent report from Bloomberg uncovered that two of the largest online lenders do not verify income and employment in a significant percentage of the loans they make.[10] Another marketplace lender did not verify income or employment for about 25% of their loans. Yet another didn't verify income or employment for about 2/3 of its loans. [11] What does this mean for borrowers? Often borrowers are burdened with the failure of the loan, not lenders or investors. Unaffordable loans can have devastating consequences for anybody, but particularly for low-income consumers.[12] Often these loans take a super lien by gaining direct access to a borrower's bank account, which means a domino effect could cause delinquency on other bills, increased likelihood of overdraft fees, and even bank account closures. This is the start of a vicious cycle whereby damaged credit scores increase the barriers to a borrowers' ability to access more affordable products in the future, as well as jobs, housing, and insurance. Further, in an economic downturn, if many borrowers are forced to default at once, this could leave lenders or investors with significant losses and lead to larger systemic harms.

What is the Role of State Law in a "National" Fintech Marketplace?

Another central concern in is fintech's facilitation of the evasion and preemption of state consumer protections. State usury caps play an important role in protecting consumers from predatory and wealth stripping credit products. In addition, States are actively working to assert their long-held authority over regulation of non-banking lending, particularly as it regards to price and other concerns.[13] This is particularly of concern when federal law does not cover the costs of

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[10] Matt Scully, "Biggest Online Lenders Don't Always Check Key Borrower Data", BLOOMBERG (June 14, 2017), *available at* https://www.bloomberg.com/news/articles/2017-06-14/biggest-online-lenders-don-t-always-check-key-borrower-details.

[11] *Id.*

[12] See for example, *Power Steering: Payday Lenders Targeting Vulnerable Michigan Communities*, Center for Responsible Lending (2018). Available at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-michigan-paydaylending-aug2018.pdf

[13] See for example; **New Hampshire** actions against many online lenders: Prosper (2016): https://www.nh.gov/banking/orders/enforcement/documents/16-035-co-20161123.pdf Upstart Network (2016): https://www.nh.gov/banking/orders/enforcement/documents/16-034-co020161220.pdf Klarna Credit (2017): https://www.nh.gov/banking/orders/enforcement/documents/17-052-co-20171108.pdf ;RockLoans Marketplace (RocketLoans) (2017): **New York Department of Financial Services** investigations into online lenders (2016) - http://fortune.com/2016/06/03/new-york-inquiry-online-lenders/ and https://www.reuters.com/article/us-new-york-regulator-internet-exclusive/new-york-state-launches-inquiry-of-online-lenders-idUSKCN0YP27N; New York Department of Financial Services report on online lending (2018): https://www.dfs.ny.gov/reportpub/online_lending_survey_rpt_07112018.pdf ; **California** action against LendUp (2016) - http://www.dbo.ca.gov/Press/press_releases/2016/LendUp%20Settlement%20Release%2009-26-16.pdf and http://www.dbo.ca.gov/Press/press_releases/2016/LendUp-Settlement%20Agreement.pdf; California investigation into high-cost lenders' online lead generation activity (just announced today!) - http://www.dbo.ca.gov/Press/press_releases/2018/Triple Digit%20APR%20Special%20Report%20Release%2009-26-18.asp; **Virginia** (2018) - Enova: https://www.oag.state.va.us/media-center/news-releases/1185-may-4-2018-herring-alleges-illegal-predatory-loans-in-suit-against-one-of-virginia-s-largest-online-lenders

loans like those considered in marketplace lending, and there is not a robust federal oversight system in place. One effort to preempt state law comes in the form of the OCC charter. Another is in the form of rent-a-bank schemes, which, as discussed below, "valid when made" or "true lender" would enable. A third is direct high-cost payday or installment lending by banks. These questions are central to the discussion below when considering some of the recommendations of the Treasury report.

II. Building a Financial System that Protects Consumers

In accordance with Executive Order 13772,[14] the United States Department of Treasury released a report on July 31, 2018 titled, "*A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation [Hereinafter "Treasury Report, or "Report"]*."[15] Recognizing that the Report covers a very expansive topic area, the remainder of this discussion will be centered around consumer lending products and services. The following Treasury Report recommendations raise particular concerns that should be addressed by financial regulators and Congress as they consider the evolving financial marketplace. In response to the financial crisis, the Report starts with the position that the impact of consumer protection law are "[...] policy changes [that] made certain product segments unprofitable for banks, thereby driving activity outside the banking sector and creating opportunities for emerging non-bank financial firms to address unmet market demands."[16] This statement mischaracterizes the impact of consumer protections that save borrowers billions in inappropriate charges and prevent long-term debt traps that do not provide any benefit to the borrower. In some cases, these products and abusive practices contributed to, and prolonged, the financial crisis and put the safety and soundness as well as the reputations of banks at risk. The reemergence of payday type loans or rent-a-bank charter agreements with non-banks is at the expense of consumers and is not a market response to demand for high cost, poorly underwritten loans.

MoneyLion: https://www.oag.state.va.us/media-center/news-releases/1122-february-7-2018-virginia-consumers-to-receive-2-7-million-in-relief-from-settlement-with-internet-lender; **Colorado** actions against Marlette Funding, Avant (2017) ; **Pennsylvania** action against Think Finance (2014) - Commonwealth of Pennsylvania v. Think Finance, Inc., et al., Civil Action No. 14-cv-7139 (E.D. Pa); **Vermont** (2014): Campaign against online lending - http://ago.vermont.gov/wp-content/uploads/2018/01/Illegal-Lending-Report-April-2014.pdf; **Florida:** http://www.myfloridalegal.com/newsrel.nsf/newsreleases/2F836464563D0EB5852580A600709370

[14] Executive Order 13772, *Core Principles for Regulating the United States Financial System*, issued February 3, 2017.

[15] Treasury Report, supra n. 1

[16] *Id*, at 4-5

- <u>The danger of preemption: The OCC charter and the preemption of State law</u>

The Treasury Report recommends that the OCC move forward with its special purpose national charter.[17] The OCC released a proposal for a special purpose national bank charter for financial technology companies and solicited comments on that proposal in December 2016.[18] Very soon after the report was published the OCC announced it would begin considering applications for special purpose charters. CRL is deeply concerned that an OCC special purpose charter would be used to preempt or circumvent state law. We also strongly disagree with the Report's conclusion that the OCC has addressed the preemption issue, along with other consumer protections, because "it would encourage special purpose national bank charter applicants to meet an ongoing financial inclusion standard of "provid[ing] fair access to financial services by helping to meet the credit needs of its entire community" through setting supervisory expectations and making such a commitment a condition for charter approval."[19] This is far from an adequate resolution to the preemption of state usury limits, which have served as effective protections against predatory lenders. A special purpose non-bank charter will enable preemption of state oversight and authority and would allow almost any entity to readily serve as vehicle for unaffordable loans.

Research from the Center for Responsible Lending and other organizations shows that the OCC's aggressive preemption of state laws has historically been a significant factor in contributing to consumer harm, particularly with regard to mortgage lending. For example, in 2006, in the lead up to the financial crisis, national banks, federal thrifts, and their subsidiaries made almost a third of subprime loans, 40% of Alt-A loans, and 51% of interest-only and option ARM loans. In total over $700 billion in hazardous loans were made by banks and nonbanks that states were unable to regulate because of OCC preemption. We understand that the OCC seeks to expand financial

[17] "Treasury recommends that the OCC move forward with prudent and carefully considered applications for special purpose national bank charters. OCC special purpose national banks should not be permitted to accept FDIC-insured deposits, to reduce risks to taxpayers. The OCC should consider whether it is appropriate to apply financial inclusion requirements to special purpose national banks. The Federal Reserve should assess whether OCC special purpose national banks should receive access to federal payment services."[17]

[18] See Treasury Report pp. 71-73 for full discussion of charter: See p 71, note 196 for further discussion on the OCC announcement ("The OCC special purpose national bank charter was proposed through a series of OCC announcements. See Office of the Comptroller of the Currency, Exploring Special Purpose National Bank Charters for Fintech Companies (Dec. 2016), available at: https://www.occ.gov/topics/responsible-innovation/comments/special- purpose-national-bank-charters-for- ntech.pdf; ("OCC Fintech Paper"); Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective (Mar. 2016), available at: https://www.occ.gov/ publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ- perspective.pdf; Summary of Comments and Explanatory Statement: Special Purpose National Bank Charters for Financial Technology Companies (Mar. 2017), available at: https://www.occ.gov/topics/responsible-innovation/summary-explanatory-statement- ntech-charters.pdf ("OCC Comment Summary"); Draft Licensing Manual Supplement (Mar. 2017), available at: https://www.occ.gov/publications/publications-by-type/licensing- manuals/ le-pub-lm- ntech-licensing-manual-supplement.pdf."

[19] Treasury at 72

inclusion and lead innovation through issuing non-bank charters to fintech institutions. However, there is insufficient evidence that the OCC puts the needs and best interests of consumers ahead of the interests of the banks it supervises. We believe that if the OCC proceeds with granting a federal charter to fintech companies, the OCC will ultimately undermine the consumer protection regulatory framework that has been called for by the general public. We concur with the National Consumer Law Center (NCLC) in their remarks stating that safety and soundness supervision and enforcement of federal laws do not replace substantive state laws that do not have a federal counterpart.[20] For example, the Consumer Bureau recently brought enforcement action against LendUp, a fintech non-bank lender, for deceptive conduct.[21] LendUp charged rates as high as 300% APR on some of its loans,[22] even though it marketed itself as a "financial innovator" that was expanding access to credit, LendUp was determined to be in violation of state law by the California Department of Business Oversight, because it was charging impermissible fees on their loans.[23] CRL has thoroughly documented state enforcement actions related to lenders originating gaps illegal loans.[24] Given the destructive and devastating consequences of predatory loan products, the OCC should not take any action that will compromise a states' ability to prosecute usurious practices.

- The federal government should not preempt critical state usury limits by sanctioning rent-a-bank schemes in the name of "valid when made" or "true lender" policies.

Another attack on state consumer protection laws has come in the form of efforts to codify so-called "valid when made" and "true lender" doctrines, which would enable rent-a-bank schemes that could gut state interest rate caps. Treasury recommends Congress codify both doctrines;[25] that

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[20] National Consumer Law Center, Comment, Comments to the Comptroller of the Currency on "Exploring Special Purpose National Bank Charters for Fintech Companies" available at http://www.nclc.org/images/pdf/banking_and_payment_systems/fintech/comments-fintech-jan2017.pdf

[21] In the Matter of Flurish, Inc., dba LendUp, Consent Order (Sep. 27, 2016), available at http://files.consumerfinance.gov/f/documents/092016_cfpb_LendUpConsentOrder.pdf.

[22] The Commissioner of Business Oversight v. Flurish, Inc. (dba LendUp), Settlement Agreement signed Sept. 23, 2016 (the state enforcement agency found that LendUp had committed a total of 385,050 individual violations of state laws protecting consumers), available at http://www.dbo.ca.gov/Press/press_releases/2016/LendUp-Settlement%20Agreement.pdf.

[23] Press Release, Consumer Fin. Prot. Bureau, CFPB Orders LendUp to Pay $3.63 Million for Failing to Deliver Promised Benefits: Online Lender Did Not Help Consumers Build Credit or Access Cheaper Loans, As It Claimed (Sept. 27, 2016), available at http://www.consumerfinance.gov/about-us/newsroom/lendup-enforcement-action/.

[24] Diane Standaert & Brandon Coleman, Ending the Cycle of Evasion: Effective State and Federal Payday Lending Enforcement, Center for Responsible Lending (Nov. 2015), available at http://www.responsiblelending.org/payday-lending/research-analysis/crl_payday_enforcement_brief_nov2015.pdf.

[25] Treasury Report at 203, "Treasury recommends that Congress codify the "valid when made" doctrine to preserve the functioning of U.S. credit markets and the long- standing ability of banks and other financial institutions, including marketplace lenders, to buy and sell validly made loans

banking regulators use their authorities to reinforce the same; and even that states revise their laws to essentially exempt entities partnering with banks. But such steps would gravely undermine the strongest protection we have against predatory lending—state usury limits—and, contrary to claims from those pushing the legislation, they are not necessary to ensure access to affordable credit.

Decades ago, a few banks – which are generally not subject to state interest rate limits – began renting out their charters to enable payday lenders to make high-cost loans in states where high rates are prohibited. Those schemes were ultimately shut down, and since the mid-2000s, federal regulators have generally kept rent-a-bank arrangements for short-term payday loans at bay. At that time, OCC Comptroller Hawke called rent-a-bank schemes "an abuse of the national charter"[26] and cautioned that "[t]he benefit that national banks enjoy by reason of [preemption] cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank."[27] But these schemes have continued to spring up for high-cost installment loans. Elevate makes loans at 100% interest using Republic Bank & Trust in Kentucky, ignoring the voter-approved 36% or lower rate caps in Arkansas, Montana, South Dakota and other states. CashCall made loans up to 99% in Maryland and West Virginia using First Bank of Delaware and First Bank & Trust, though courts later shut them down. On Deck Capital makes small business loans with rates up to 99.7% APR, originating loans through Celtic Bank in states where it cannot make the loans directly.

Marketplace lenders are also using banks to charge rates up to 36% that are not permitted in many states for large loans of $30,000 to $40,000; the State of Colorado has sued two marketplace lenders, Avant and Marlette, for using rent-a-bank arrangements to hide the fact that these state-regulated lenders are the true lender. In rent-a-bank operations—both old and new—the non-bank lender is in the driver's seat. The bank is a façade, originating the loan and perhaps

without the risk of coming into conflict with state interest rate limits. Additionally, the federal banking regulators should use their available authorities to address challenges posed by Madden."; "Treasury recommends that Congress codify that the existence of a service or economic relationship between a bank and a third party (including financial technology companies) does not affect the role of the bank as the true lender of loans it makes. Further, federal banking regulators should also reaffirm (through additional clarification of applicable compliance and risk-management requirements, for example) that the bank remains the true lender under such partnership arrangements."; "Treasury recognizes the role of state laws and oversight in protecting consumers, but such state regulation should not occur in a manner that hinders bank partnership models already operating in a safe and sound manner with appropriate consumer protections. Treasury recommends that states revise credit services laws to exclude businesses that solicit, market, or originate loans on behalf of a federal depository institution pursuant to a partnership agreement."

[26] The Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Reserve Board, and FDIC all shut down rent-a-bank in the early-to-mid 2000s.

[27] https://www.occ.treas.gov/news-issuances/news-releases/2002/nr-occ-2002-10.html.

having a minor additional role that merely serves as cover for the fact that the main value the bank adds is its interest rate preemption rights. Typically, virtually all aspects of the loan program other than origination are handled by the non-bank lender, which may include setting the loan terms, designing the underwriting criteria, handling the website, marketing the loans, taking and processing applications, servicing the loans, handling customer service, and, for securitized loans, packaging the loans for investors. While the bank may approve aspects of these operations, the vast majority of the work and the vast majority of the profits go to the non-bank lender.[28]

The Treasury Report correctly identifies the concerns expressed by consumer advocates when they state "[...] consumer groups have expressed concern that the bank partnership model can harm consumers by allowing partnering firms to bypass state-based usury limits and other state requirements. Advocates note that some lenders operate with high-APR business models and offer loans whose APRs can exceed 100%, when fees are included. Beyond enabling high-APR products, advocates note that in the past, such third-party partnerships have enabled some deceptive practices." [29] The Report however, does not address these concerns specifically, and instead goes on to state after some discussion: "Treasury recognizes that these existing bank partnership arrangements have generally enhanced the provision of credit to consumers and small businesses."[30] Again we see a recognition of key consumer protection issues immediately swept under the rug, and replaced with a claim about financial access equaling consumer benefit without convincing data.

The so-called "true lender" rent-a-bank bill, H.R. 4439, or the sanctioning of this rouse by a federal banking agency, would place a blanket stamp of approval on bank partnerships that evade state law. We note that the OCC's recent installment loan guidelines advised against rent-a-bank

[28] These undisputed facts recited by the court are virtually identical to the payday lender rent-a-bank arrangements of 20 years ago:

> For example, Avant, Inc. paid the implementation fee to initiate the lending program, paid all of WebBank's legal fees in the program, bears all of the expenses incurred in marketing the lending program to consumers, determines which loan applicants will receive Avant Loans and bears all costs of making these determinations, ensures the program complies with federal and state law, assumes responsibility for all servicing and administration of the Avant Loans "even during the period before WebBank sells the loans to Avant, Inc. or its affiliates," and assumes responsibility for all communications with loan applicants and consumers who receive Avant Loans. [Id. at 34(a)-(j)] Additionally, Avant, Inc. bears all risk of default, and indemnifies WebBank against all claims arising from WebBank's participation in the lending program. [Id. at 34(l)] Avant, Inc., along with the other non-bank entities, collects 99% of the profits on the loans while "WebBank's share in the profit is only approximately one percent.

Meade v. Avant of Colorado, LLC, 2018 WL 1101672 (D. Colo. Mar. 1, 2018). Avant attempted to distinguish itself from the rent-a-bank arrangements 20 years ago on the grounds that payday lenders claimed to be agents of the bank whereas Avant was an assignee of the loans. That is not only a distinction without a difference, it is not even a distinction. Payday lenders in the past were also assignees of the loans, and Avant also claims to be a bank "service provider" (i.e., an agent).

[29] *Id.* at 91, n 247, n 248

[30] *Id.* at 92

schemes. The bills currently introduced[31] to override the Second Circuit's Madden v. Midland decision, would also severely undermine the effectiveness of state interest rate caps. which held that a debt buyer purchasing debts originated by a national bank could not take advantage of the National Bank Act's preemption of state interest rate caps. Because there are no federal usury caps,[32] chartered institutions would have no actual limit on the interest rates and fees they could charge to borrowers, federal preemption for non-bank entities would have the functional effect of abolishing established state interest rate caps that protect consumers and, by extension, many small businesses from predatory and unaffordable loans. Currently, over 90 million people live in the 15 states plus the District of Columbia that enforce interest rate caps to prevent abusive high cost short term loans and debt trap products.[33] Collectively, these states save over $5 billion in fees that would otherwise be paid toward unaffordable loans.[34] Many of these states have always prohibited predatory loans in their state, aggressively enforcing their strict usury limits. Many more states have interest rate caps on installment loans that are much lower than rates offered by marketplace or higher-cost lenders. States have adamantly worked, over many years, to enact, enforce, and protect against the abuses of high-cost loans and resisted numerous attempts by predatory lenders to evade these protections. The *Madde*n decision did not limit the interest rates that banks may charge on credit cards and other forms of credit, but what it does prevent is the evasion of state interest rate caps by a rent-a-charter agreement. Reversing the Second Circuit's decision would open a huge loop hole for payday lenders, debt buyers, online lenders, fintech companies, and other companies to use "rent-a-bank" arrangements to charge high usurious and predatory rates on loans. The rent-a-bank bills provide that "a loan that is valid when made as to its maximum rate of interest ... shall remain valid with respect to such rate regardless of whether the loan is subsequently sold, assigned, or otherwise transferred to a third party, and may be enforced by such third party notwithstanding any State law to the contrary."

For example, CashCall has attempted to partner with banks to make usurious loans in numerous states. Courts have struck down those arrangements, finding that CashCall had to

[31] H.R. 3299 and S.1642
[32]. The Military Lending Act establishes a 36% rate cap for service members and their families.
[33] Center for Responsible Lending, U.S. Payday Interest Rates Calculated on a Typical Loan (May 2016), available at http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_payday_rate_cap_map_2016.pdf.
[34] Delvin Davis & Susan Lupton, States without Payday and Car-title Lending Save Over $5 Billion in Fees Annually, Center for Responsible Lending (Updated Jan. 2017), available at http://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl_payday_fee_savings_jun2016.pdf.

comply with state interest rate caps.[35] Legislation that pre-empts state usury laws could undermine decisions like these, by stating that a loan's interest rate remains valid even if a loan is transferred or assigned to a third party and "may be enforced by such third party notwithstanding any State law to the contrary." This would enable high-rate lenders to use banks to originate and then immediately transfer usurious loans, in essence loan laundering usurious loans through their bank charter. Importantly, efforts to extend preemption to nonbank entities run counter to the Wall Street Reform Act. While reaffirming the principle of bank preemption of some state laws, Dodd-Frank reversed a Supreme Court decision that extended preemption to operating subsidiaries of national banks, limiting preemption to the bank itself. Rent-a-bank schemes are even less connected to actions of the bank itself than activities of bank subsidiaries are.

States have weighed in on this already. In a letter by 20 State Attorneys General opposing provisions in another similar bill that would have overturned the Madden decision, the state law enforcement officers warned that the bill "would restrict states' abilities to enforce interest rate caps. It is essential to preserve the ability of individual states to enforce their existing usury caps and oppose any measures to enact a federal law that would preempt state usury caps."[36] In fact, the Colorado Attorney General is in the midst of challenging online lenders' use of a rent-a-bank scheme to make loans in violation of the state's usury limits.[37]

On a policy level, these bills are not a necessary "fix" to ensure access to affordable credit. Supporters of the bills claim that the *Madden* decision has had an adverse impact on access to credit, citing a study that showed a decrease in marketplace lending by three lenders in the Second Circuit to subprime borrowers after the Madden decision, especially for borrowers with FICO scores below 644. However, the study showed that even before the Madden decision these lenders offered a very small amount of credit in the low FICO range.[38] Thus, the impact on access to credit was inconsequential. Moreover, it is likely that the credit extended before the decision at the lower end of the FICO spectrum was made to borrowers who had trouble repaying, and that lenders were

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[35] See, e.g., CashCall, Inc. v. Maryland Com'r of Financial Regulation, 139 A.3d 990 (Md,. Ct. App. 2016); CashCall, Inc. v. Morrisey, 2014 WL 2404300 (W. Va. May 30, 2014).
[36] Letter from Eric T. Schneiderman, New York Attorney General, to Paul Ryan, Speaker, U.S. House of Representatives, et. al. (June 7, 2017), available at https://ag.ny.gov/sites/default/files/6.7.2017_choice_act_letter.pdf.
[37] Colorado Moves to Dismiss Lawsuits by Banks Seeking Judgment in Online Lending Cases", LENDIT NEWS (May 1, 2017), available at http://www.lendit.com/news/2017/05/01/colorado-moves-dismiss-lawsuits-banksseeking-judgement-online-lending-cases.
[38] Colleen Honigsberg et al., The Effects of Usury Laws on Higher-Risk Borrowers, Columbia Business School Research Paper No. 16-38 (Dec. 2 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2780215 (see Before Madden and After Madden chart on page 44).

relying on high interest rates on large loans to offset for high default rates. Contrary to what lenders often claim, robust state loan laws do not drive people to find loans online. In fact, illegal online lending is more prevalent in states that do not effectively regulate predatory lending than it is in states that enforce state interest rate caps.

- Exposing Consumers to debt traps by repealing the Payday Rule

The Treasury paper recommends changes to the regulation of small dollar loans that would both leave consumers vulnerable to debt trap payday loans from non-bank lenders and expose them to new risks of the same from depositories.[39] The Consumer Bureau's final payday rule, with a compliance date of August 2019, reins in payday and car title lending abuses by preventing these lenders from trapping consumers in an endless cycle of unaffordable 300% interest debt. At its core, the Consumer Bureau's payday rule is based on the common-sense principle that lenders have a responsibility to determine whether a borrower can afford to repay the loan without getting stuck in a cycle of unaffordable debt. This principle is particularly important for high-cost loans where lenders can seize funds from the borrower's bank account or repossess their car if they default. An ability-to-repay requirement is a sensible and sound approach and a principle that, according to a recent poll of likely voters, is supported by Republicans, Independents, and Democrats by a 20-point margin.[40]

This rule is the culmination of over five years of stakeholder input and extensive research by the Consumer Bureau demonstrating the harm caused by making loans without considering a borrower's ability-to-repay. A large body of research has demonstrated that payday and car title loans are structured to create a long-term debt trap that drains consumers' bank accounts and causes significant financial harm, including delinquency and default; fees for overdraft and

[39] Treasury Report, 2017. *"Treasury recognizes and supports the broad authority of states that have established comprehensive product restrictions and licensing requirements on nonbank short-term, small-dollar installment lenders and their products. As a result, Treasury believes additional federal regulation is unnecessary and recommends the Bureau rescind its Payday Rule." "Treasury recommends the federal and state financial regulators take steps to encourage sustainable and responsible short-term, small dollar installment lending by banks. Specifically, Treasury recommends that the FDIC reconsider its guidance on direct deposit advance services and issue new guidance similar to the OCC's core lending principles for short-term, small-dollar installment lending."*

[40] "AFR/CRL Poll of 1000 Likely Voters Nationwide by Telephone," July 28, 2018. https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-afr-pollmemo-fullresults-jul2018.pdf. Q: Currently, mortgage lenders are always required to verify a borrower's ability to repay before issuing the mortgage. Some people have suggested flexibility and adding exceptions to this requirement, so that lenders can issue some mortgages without having to determine a borrower's ability to repay. Which would you favor: FLEXIBLE requirements, so some mortgages can be issued without verifying ability to repay, or TIGHTER requirements that lenders must fully verify the ability to repay for ALL mortgages? Do you favor flexible/tighter requirements strongly or just somewhat?

insufficient funds; increased difficulty paying mortgages, rent, and other bills; loss of checking accounts; and bankruptcy. A large portion of borrowers eventually default, but many times only after borrowers have paid hundreds or even thousands of dollars in fees.

Contrary to the Treasury Report's suggestion that the Consumer Bureau rule does not leave room for state regulation, the rule serves as a regulatory floor, without preempting existing or future state laws that go further than the federal rule to protect consumers from debt-trap loans.[41] Thus, in the 15 states plus D.C. with rate caps on short-term loans, those caps remain in place, and in the remaining 35 states, the rule provides critical protection.[42] In fact, Congress charged the Consumer Bureau with addressing unfair and abusive practices, which is what this rule does—with the reasonable requirement that lenders determine whether borrowers can afford the loans. Additionally, the rule provides additional enforcement tools to the states, as state Attorneys General and regulators will be able to enforce the rule against actors making unfair and abusive payday loans in their state.[43] And contrary to payday lender industry claims, the payday lending rule will not hamper access to needed credit. The rule takes aim only at unaffordable credit that leads to a debt trap, by requiring only that lenders determine whether a borrower has the ability-to-repay the loan before making it. The payday lender business model is not about providing credit; it's about creating a debt trap. Over four out of five payday loans—more than 80%—are taken out within a month of the borrower's prior loan. In essence, payday lenders generate their own demand by making unaffordable loans.

Finally, the Consumer Bureau rule addresses unfair and abusive practices that the Bureau found could not be adequately addressed through disclosure. The Consumer Bureau studied whether disclosure alone could address the core harms from cycles of repeat loans that the rule aims to prevent. Evidence from a field trial of disclosures aimed specifically at reborrowing showed only a marginal effect on repeat loans. Analysis of actual disclosures implemented in Texas showed that the likelihood of a repeat loan decreased by only 2% following implementation.[44] The Consumer Bureau concluded that the impact of disclosures on the core harm caused by repeat loans was "nearly negligible."[45] It attributed the inadequacy of disclosure

[41] See, Payday Lending Rule: Myths & Facts, Center for Responsible Lending (2018). Available at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-payday-cra-myths-apr2018_0.pdf
[42] *Id.*
[43] *Id*
[44] *Id.*
[45] *Id*

in part to the strong incentives payday lenders have to ensure borrowers stay in long cycles of repeat loans. Meanwhile, the Treasury report includes recommendations for banking regulators that could lead to proliferation of high-cost payday and installment loans by banks.

- Short-term payday loans by banks. The FDIC should retain, and OCC should re-institute, their guidance addressing "deposit advance" loans.

The Treasury paper recommends that the FDIC reconsider its 2013 guidance addressing "deposit advance" bank payday loans. In 2013, a handful of banks were making high-cost payday "deposit advance" loans, structured just like loans made by non-bank payday lenders. The bank repaid itself the loan in full directly from the borrower's next incoming direct deposit, typically wages or Social Security, along with annual interest averaging 225% to 300%. Among their many victims was Annette Smith, a widow who relied on Social Security for her income. Annette testified before Congress about a Wells Fargo "direct deposit advance" for $500 that cost her nearly $3,000.[46] Annette's experience was hardly an aberration.[47] Over half of deposit advance borrowers had more than ten loans annually,[48] despite so-called protections like installment plans. Additionally, deposit-advance borrowers were seven times more likely to have their accounts charged off than their counterparts who did not take out these loans.[49] But the banks setting these debt traps dug in, defending them staunchly. At their peak, bank payday loans—even with only six banks making them—drained roughly half a billion dollars from bank customers annually. This cost does not include the severe broader harm that the payday loan debt trap has been shown to cause, including overdraft and non-sufficient funds fees, increased difficulty paying mortgages, rent, and other bills, loss of checking accounts, and bankruptcy. Payday lending has a particularly adverse impact on African-Americans and Latinos. A disproportionate share of payday borrowers come from communities of color, and bank payday loans that jeopardize their bank accounts can leave these communities even more disproportionately underserved by the banking mainstream.

Payday lending by banks was met by fierce opposition from virtually every sphere—the military community, community organizations, civil rights leaders, faith leaders, socially

[46] Testimony of Annette Smith Before the Senate Special Committee on Aging, "Payday Loans: Short-term Solution or Long-term Problem?", July 24, 2013, *available at* https://www.youtube.com/watch?time_continue=50&v=UG7B3L3oDN8.
[47] Rebecca Borné and Peter Smith, *The State of Lending in America and Its Impact on U.S. Households: Bank Payday Lending*, Center for Responsible Lending (Sept. 2013), https://www.responsiblelending.org/state-lending/bank-payday-loans.
[48] Rebecca Borné, *Been There, Done That: Banks Should Stay Out of Payday Lending*, Center for Responsible Lending (July 2017), http://www.responsiblelending.org/research-publication/been-there-done-banks-should-stay-out-payday-lending.
[49] CFPB, Supplemental Findings on payday, payday installment, and vehicle title loans, and deposit advance products (June 2016), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf

responsible investors, state legislators, and members of Congress. The FDIC and OCC's 2013 guidances requiring an income-and-expense-based ability-to-repay determination, and the Federal Reserve's supervisory statement emphasizing the "significant consumer risks" bank payday lending poses. As a result of these actions, most bank payday lending programs were suspended (Fifth Third is the notable exemption, as it continues to make short-term payday loans) and bank customers were generally protected from a devastating debt traps at the hands of their bank.

We were deeply discouraged by the OCC's rescission of its deposit advance guidance in October 2017. In response, more than 230 groups signed an open letter to banks urging them to stay out of payday lending. The OCC rationalized this rescission in part by noting that the Consumer Financial Protection Bureau's finalization of its payday lending rule earlier that day subjected banks to potentially inconsistent regulation.[50] But the CFPB's rule and the deposit advance guidance are both necessary and are complimentary. Moreover, the CFPB has since publicly announced that it is reconsidering its rule, and rescission of the deposit advance guidance could leave borrowers entirely unprotected from debt-trap lending by our nation's banks.

The OCC also noted that banks should offer more short-term credit because banks are more regulated than non-bank lenders and thus can do so at less risk to the consumer. The Treasury Department expressed the same notion in its fintech paper. But again, the data on bank payday loans left no question that bank payday loans were the same as those made by non-bank lenders—high-cost, unaffordable, debt-traps.[51]

- <u>High-cost installment loans by banks — Banks should keep loans at no more than 36% APR and should determine ability-to-repay based on income and expenses.</u>

The Treasury paper also recommended that the FDIC issue installment loan principles similar to the OCC's May installment loans bulletin. But the OCC's guidelines lack sufficient guardrails around ability-to-repay and price. Meanwhile, the National Credit Union Administration (NCUA)

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[50] The OCC's rescission following finalization of the CFPB rule was immediate, even as the CFPB rule's compliance date is not until August 2019.

[51] Deposit advance borrowers were seven times more likely to have their accounts charged off than their counterparts who did not take deposit advance loans. Further, following discontinuation of deposit advance, former borrowers, compared to non-borrowers, did not incur an increase in overdraft or NSF fees. CFPB, *Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products* at 39 (June 2016), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf.

is also considering a dangerous new program, opposed by many groups,[52] that could facilitate unlimited flipping of short-term high-cost loans,[53] as well as unaffordable longer-term loans.

The FDIC already has installment loans guidelines advising a cap of 36% — and it should reinforce them. Other regulators should join. And NCUA should not expand its program in unsound ways. In addition, all regulators should emphasize that loans should be made based on an ability-to-repay determination based on income and expenses. Civil rights, consumer and faith groups have continually voiced strong opposition to bank lending in excess of 36% APR, and urged consideration of both income and expenses, registering these concerns with regulators and banks alike.[54]

U.S. Bank recently stepped through the door opened by the OCC's installment loan bulletin. The bank introduced "Simple Loan," a three-month installment loan of up to $1,000 at a typical APR of 70% (and up to 88%) that would be illegally high in approximately 31 states plus D.C. if made by a nonbank lender.[55] This product will be unaffordable for many borrowers and ultimately erode protections from predatory lending across the board. A supposed safeguard of the U.S. Bank product, and one floated as a "safeguard" in a variety of other high-cost loan contexts, is limiting payments to 5% of gross income. But data simply do not support that this metric—which disregards the expenses of financially distressed consumers—is a meaningful affordability standard for high-cost loans. In fact, federal government research on more than one million loans found default rates of more than 38% at payment-to-income ratio of 5% or less.[56]

Common sense doesn't support this notion either. Payday borrowers have very low incomes, are typically already overburdened by credit, and have average credit scores in the low 500s. Consider a family of four at the federal poverty level of $24,300 annually, $2,025 monthly. Consider also that 55% of renters who earn less than $30,000 pay more than 50% of gross income

[52] Comments of 100+ community, consumer, civil rights, faith, and legal services groups to NCUA on Proposed Payday Alternative Loan (PAL) Rule (Aug. 3, 2018), http://stopthedebttrap.org/blog/proposed-rule-credit-union-payday-alternative-loans-shouldnt-permit-cycle-high-cost-debt/.
[53] Comments of the Center for Responsible Lending, Self-Help Federal Credit Union, Self-Help Credit Union, and the National Consumer Law Center (on behalf of its low income clients) to NCUA on Proposed PAL Rule (Aug. 3, 2018), https://www.responsiblelending.org/research-publication/comments-response-national-credit-union-administration-proposal-expand-its.
[54] Letter from national civil rights, faith, and consumer groups to federal banking regulators (May 4, 2018), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-bank-usury-joint-regulators-4may2018.pdf; Letter from community, civil rights, faith, and consumer groups to FDIC Chair McWilliams (Aug. 21, 2018), https://www.responsiblelending.org/media/fdic-should-not-allow-banks-make-payday-loans-says-coalition-letter; Open Letter to Banks: Don't Make Debt Trap Payday Loans, signed by over 200 groups (Nov. 3, 2017), https://www.responsiblelending.org/research-publication/open-letter-banks-dont-make-debt-trap-payday-loans.
[55] Even a lower rate of 60% is deemed too high by 93% of North Carolina voters. Poll by Public Opinion Strategies and released by CRL (Apr. 8, 2015), https://www.responsiblelending.org/media/poll-what-unites-93-tar-heels-opposition-predatory-lending-and-bill-pushing-interest-rates.
[56] Stop the Debt Trap, *Assessing Both Income and Expenses Is Necessary in Test of Borrower's Ability to Afford a Consumer Loan* (Nov. 9, 2017), http://stopthedebttrap.org/wp-content/uploads/2017/11/stdt-5percent-nov2017.pdf

for rent alone.[57] A 5% PTI standard assumes that this borrower has an extra $101 each month, or $1,215 annually, to spare toward high-cost debt. For most borrowers, this assumption doesn't match reality. And history has shown us that, rather than substitute for other high-cost products, additional high-cost loans push already constrained borrowers further into unsustainable debt. Payday loans, including deposit advance loans, have not been shown to reduce overdraft fees.[58] In fact, software consultants for bank payday loans, and for proposed new NCUA "payday alternative loans" (PALs), tout "[l]ittle to no cannibalization of NSF/OD [overdraft] income."[59] Yet payday loans are consistently shown to trigger overdraft fees.[60]

Similarly, when banks were making deposit advance loans at price points of half or two-thirds that of storefront lenders, with annual volume of $6.5 billion (most of it, like storefront payday loan volume, generated by the previous unaffordable payday loan),[61] there was no evidence that they put a dent in nonbank payday lending. High-cost installment loans also often add to already unsustainable debt burdens. In Colorado, where installment loans average 129% APR, a default or delinquency occurred in 23% of all 2016 loans.[62] Even when the loans are repaid, focus group participants there describe how these loans often compounded their already unmanageable debt burdens.[63]

Thus, we know of no evidence suggesting that high-cost bank installment loans will drive down nonbank payday lending. They do, however, threaten a race to the bottom as nonbank lenders will seek to loosen state usury laws to "compete" with banks, threatening the most meaningful protection against predatory lending: state usury limits. Moreover, banks and credit unions do not need special passes to make reasonably priced loans. Many depositories make affordable

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[57] Joint Center for Housing Studies of Harvard University, *The State of the Nation's Housing 2018* (2018), http://www.jchs.harvard.edu/sites/default/files/Harvard_JCHS_State_of_the_Nations_Housing_2018.pdf.

[58] CFPB, *Supplemental findings on payday, payday installment, and vehicle title loans, and deposit advance products* at 39 (June 2016), https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf.

[59] https://www.cashplease.com/financial-institution-benefits/.

[60] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* at 33-34 (2013), *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf; CFPB, *Online Payday Loan Payments* (2016), https://files.consumerfinance.gov/f/201604_cfpb_online-payday-loan-payments.pdf; Susanna Montezemolo & Sarah Wolff, *Payday Mayday: Visible and Invisible Payday Lending Defaults*, Center for Responsible Lending (March 2015), https://www.responsiblelending.org/research-publication/payday-mayday-visible-and.

[61] Leslie Parrish & Uriah King, *Phantom Demand*, Center for Responsible Lending (2009), http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

[62] Ellen Harnick & Delvin Davis, *Payday Lenders Continue to Put Coloradoans Into High-Cost Debt*, Center for Responsible Lending (Feb. 2018), https://www.responsiblelending.org/media/new-report-coloradans-pay-119-borrow-392-through-payday-lending.

[63] Tom Feltner, Diane Standaert, & Ellen Harnick, *Sinking Feeling: Colorado Borrowers Describe Their Experiences With Payday Loans*, Center for Responsible Lending (July 2018), https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-sinking-feeling-jul2018.pdf.

installment loans,[64] and around 650 credit unions lend under the current rules of the NCUA payday alternative loan program. There are also 76 million open subprime credit cards, up steadily since it was 59 million in 2012.[65]

Extremely high interest rates on loans to financially vulnerable consumers cannot be justified as everyday risk-based pricing. The rates, instead, are a red flag signaling a business model not based on ability-to-repay. Banks making loans through checking accounts have the added leverage of holding the customer's bank account. This can ease their ability to profit off loans, even if they leave borrowers without enough money to meet basic needs. The most efficient and effective way to ensure affordability is through interest rate caps of no higher than 36%. This idea is strongly supported by Americans across the political spectrum, as seen in Arizona, Ohio, Montana, and South Dakota, where voters in recent years have voted overwhelmingly in favor of this rate limit. Fifteen states and D.C. have these caps on short-term loans, many more have them on installment loans, and federal law establishes the cap for military service members.

- **Consumers are not test subjects: Regulatory Sandboxes**

The Treasury Report states that the impact of regulatory sandboxes[66] "… help foster economic growth. New ideas can facilitate market efficiency, spurring improvements to services and products. Not all innovations will succeed; some might even cause harm. Regulation should address and potentially mitigate negative externalities."[67] Here again the Treasury Report acknowledges the potential harms to consumers, and glosses over the extensive, and many times permanent, damage that consumers face with predatory loan products by designating them as simply "negative externalities." This approach unequivocally deprioritizes consumer protection and seems to reject the clear research data that concludes predatory loans are toxic. The notion that certain laws, especially civil rights, need to be suspended or scaled back to provide a clearing for innovation is very troubling. For example, the permeance of the impact on consumers, should not be tossed aside, and the generational wealth that can be at risk by foreclosures, damaged credit, or

[64] Stop the Debt Trap, *Assessing Both Income and Expenses Is Necessary in Test of Borrower's Ability to Afford a Consumer Loan* (Nov. 9, 2017), http://stopthedebttrap.org/wp-content/uploads/2017/11/stdt-5percent-nov2017.pdf.
[65] American Bankers Association, Credit Card Market Monitor (July 2018), https://www.aba.com/Press/Documents/2018Q1CreditCardMonitor.pdf.
[66] *"Treasury recommends that federal and state financial regulators establish a unified solution that coordinates and expedites regulatory relief under applicable laws and regulations to permit meaningful experimentation for innovative products, services, and processes. Such efforts would form, in essence, a "regulatory sandbox" that can enhance and promote innovation. If financial regulators are unable to full those objectives, however, Treasury recommends that Congress consider legislation to provide for a single process consistent with the principles detailed in the report, including preemption of state laws if necessary."*
[67] *Id, 167*

loss of bank accounts, are all protected by state and federal laws that were enacted to specifically remedy market failures and inequities. Secondly, the controlled results of a specific sandbox agreement provide an incongruous comparison with what would happen with the same model that had to account for a marketplace with consumer protections. There is no sound policy justification as to why innovation should not evolve in lock step with current consumer credit and civil rights laws, to ensure that the data and results of sandbox models can reliably be used for predictive products and innovations in a safe, sound and legally permissible manner. When the Report states "[t]he regulatory environment should instead be flexible so that firms can experiment without the threat of enforcement actions that would imperil the existence of a firm",[68] it is clear that, for the Treasury, consumer protection is not only an afterthought, but is in fact an obstacle. This is an unacceptable position when the entirety of consumer well-being is at stake, and there is not sound equitable policy reason to prevent innovation from evolving alongside critical consumer protection and civil rights laws.

- Controlling for Bias: algorithms and systemic prejudice. Treasury Recommendation on Consumer Data: A.I & Machine Learning[69]

The integration and use of algorithms and data into risk models has clear benefits when it comes to cost efficiency and streamlined underwriting. Algorithms significantly improve the time it takes to process the data that fintech companies use to determine risk, however, our concern is that the opaqueness of proprietary models, with little to no scrutiny, leave unanswered questions of consumer remedies, model discrimination, and disparate impact issues. In fact, at a certain scale, models based on discriminatory data can exacerbate market inequities. Consumer advocates are deeply concerned about the potential threat that biased data and the implementation of algorithms in fintech can have in intensifying discriminatory practices instead of limiting them.[70] It is imperative that banks and fintech companies take a proactive and comprehensive approach in analyzing the potential consumer threats that could arise from the adoption of algorithmic systems to facilitate and expedite their processes, as well as provide access to data sets and algorithms to ensure compliance with anti-discrimination laws. There needs to be strong practices in place to

[68] *Id*, at 167

[69] *Treasury Report, "Regulators should not impose unnecessary burdens or obstacles to the use of AI and machine learning and should provide greater regulatory clarity that would enable further testing and responsible deployment of these technologies by regulated financial services companies as the technologies develop."*

[70] See Andrew Waxman, *AI can help banks make better decisions, but it doesn't remove bias*, American Banker (June 5, 2018). Available at https://www.americanbanker.com/opinion/ai-can-help-banks-make-better-decisions-but-it-doesnt-remove-bias

ensure that the data used to create these algorithms is thoroughly analyzed to the highest standard to reduce the impact of bias, as well as contain systemic preventive safeguards to make sure these institutions are prepared with efficient control mechanisms that would remedy any discrimination. issues that arise.

Conclusion

As financial products and services that were once in the form of brick and mortar branches, salesmen, and desktops move online and to mobile devices it is important to remember that these products and services are not new. The products that are being utilized and offered as expanding access to credit and financial growth through financial technology are still the same products and services we've always known – they are still loans and mortgages. As this conversation moves towards questions of regulation I would urge Congress to be diligent about remembering this and ask the question "is this a traditional product or service in new packaging?" and use that as a baseline in determining how ensure that appropriate consumer protections are applied. Innovation of product delivery is very distinct from innovation of product. The former readily fits into the current consumer protection legal framework that has been instrumental to protect consumers. The latter warrants a very serious consideration of consumer impact.

Consumers will be the ones that will be hurt the most if we get this wrong.

This is why the CRL's central priorities are *(1) preserving the progress made by state and federal stakeholders to guard consumers from predatory debt trap loan products, (2) ensuring fintech lending evolves in cadence with existing and developing consumer protection laws, and (3) the preservation of state usury laws.*

Thank you again, for allowing me to share CRL's perspective today with the committee and I hope that you will consider my words and the perspective of consumers as Congress and Federal and State regulators approach the evolving fintech marketplace.

TESTIMONY OF

AARON CUTLER
PARTNER, HOGAN LOVELLS US LLP

BEFORE THE

SUBCOMMITTEE OF FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

FOR A HEARING ENTITLED
"EXAMINING OPPORTUNITIES FOR FINANCIAL MARKETS IN THE DIGITAL ERA"

SEPTEMBER 28, 2018

Good morning, Chairman Luetkemeyer, Ranking Member Clay and distinguished Members of the Subcommittee. Thank you for inviting me to testify.

My name is Aaron Cutler and I am a Partner at the law firm of Hogan Lovells US LLP in the firm's Government Relations and Public Affairs Practice Group. My practice is focused on policy, regulatory and advocacy matters across a broad array of sectors including insurance and financial services; my firm also represents depository and non-depository financial institutions, retailers and technology companies in regulatory matters related to emerging financial technology ("FinTech") innovation. Prior to joining Hogan Lovells in October of 2014, I was a staffer in the U.S. House of Representatives for five and a half years, primarily at the House Committee on Energy and Commerce and the Office of House Majority Leader Eric Cantor. I had the privilege of working closely with this Committee in my role as Senior Advisor to the Leader, so I reiterate how much of a pleasure it is to be before you today. Any statements I make reflect only my opinions and do not necessarily reflect the opinions of my law firm, colleagues or clients.

I would like to thank Chairman Luetkemeyer and Ranking Member Clay for holding this hearing. At the outset, I would like to stress that I support agile and effective regulation that enables the creation, development and deployment of safe, sound, and innovative consumer financial products and services.

FinTech products and services, including peer-to-peer and consumer lending platforms, payment systems, and a myriad of other services are already in use and continue to be rapidly adopted by U.S. consumers. As noted by the Treasury's recent report entitled "A Financial

System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation," [1] (Treasury Report) up to one-third of US consumers who are online use no less than two FinTech services.[2] Many of the FinTech products on the market provide consumers with greater access, choice, and empowerment for financial planning and decision making. The US will miss out on opportunities to realize the benefits from innovative FinTech development if it fails to take measures to improve its current regulatory structure.

As the Government Accountability Office (GAO) aptly reported in 2016,[3] the US financial services regulatory structure is complex and contains areas of fragmentation and overlap that lead to an inefficient regulatory structure. Several of the recommendations contained in the Treasury Report identify areas for improvement and increased efficiencies. Given the limited amount of time for my testimony, I will discuss only a few of the recommendations below. In light of my firm's experience in payments and open banking programs in particular, I will mainly focus on those areas.

Overall, the Treasury Report is a call to action. I appreciate and support the effort to identify related risks and also believe that the time to act is now. Taking action on many of the recommendations could, among other things, improve the regulatory framework by addressing uncertainties and inefficiencies and removing duplication. These improvements stand to benefit FinTech entities, and the industry at large, and consumers.

DATA ACCESS

Financial institutions are sitting on a goldmine of insightful data about each of their customer's spending habits and use of funds. In the right hands, this data can be used to

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[1] A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation, dated Jul. 2018, available at: https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation_0.pdf ("Treasury Report")

[2] Treasury Report p. 18.

[3] Financial Regulation, Complex and Fragmented Structure Could be Streamlined to Improve Effectiveness, dated Feb. 2016, *available at:* https://www.gao.gov/assets/680/675400.pdf

promote sound financial management, assess risk and support consumers. The information in a user's transactional accounts can, for example, be used to make highly accurate assessments of that user's credit risk (even if they have no credit history), and to help customers manage their money better, switch accounts to a more appropriate product or avoid incurring overdraft charges. It can also help with digital identity verification or even to make risk assessments for insurance products. In many cases, however, it is not the financial institutions themselves that are best able or motivated to carry out this analysis, but innovative third-parties with greater expertise in data analytics. Due to the convenience and perceived value of these services, the use by consumers of FinTech products that employ third-party data aggregation is increasing in popularity. However, financial institutions and data aggregators often find themselves at odds over data sharing and gaining efficient and reliable access to customer data continues to be a significant barrier to such services. This is part due to the prevailing regulatory regime.

Currently, financial institutions face uncertainty regarding their liability for sharing consumer account data. Section 1033 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank)[4] is the only express statutory provision relating to a consumer's access to his or her own financial account and transaction data. It requires covered financial institutions to make account transaction information in the financial institution's control "available to a consumer, upon request."[5] There are conflicting views about whether information shared with data aggregators, upon a consumer's request, are covered by Section 1033. The Treasury Report recommends that the Bureau of Consumer Financial Protection (Bureau) confirm that third parties given consumer-authorized access be covered under the definition of "consumer"[6] pursuant to Section 1002(4) of Dodd-Frank for the purpose of sharing financial account and transaction data, thereby requiring financial institutions to share the data with these third parties.

[4] Codified at 12 U.S.C. § 5533.
[5] 12 U.S.C. § 5533(a).
[6] The term "consumer" means an individual or an agent, trustee, or representative acting on behalf of an individual.

While this interpretation may help to remove current legal and regulatory uncertainties that cause reluctance on the part of financial institutions and data aggregators to enter into data sharing agreements, it will impose obligations on financial institutions to share certain customer data. Without guidance, these obligations could have unintended consequences or add other layers of uncertainty.

In my view, the overriding concern when setting a framework for open access to transactional information should be to ensure the security of the account and credentials, facilitate the customer's freedom of choice, and to allocate risk and liability appropriately to protect the customer. For many open banking projects, whether private or public, a key component of the framework is therefore enabling access via open application programming interfaces ("APIs"), rather than through use by the third party of the user's own security credentials (commonly known as 'screen-scraping'). In the case of a 'public' open banking project (i.e., one involving multiple banks and multiple third party providers), an additional consideration will be the creation of consistent standards determining how data is created, shared, and accessed – and by whom.

Any open banking system will therefore have to make decisions about means of access, liability, banking secrecy, and data protection, as well as the nature of the rights and obligations between participants. Therefore, I propose a few key considerations for the Bureau and Congress:

1. *Acceptable methods for data transmission.* As noted in the Treasury Report, the two main methods by which FinTech applications access and aggregate consumer data are "screen-scraping" and APIs.[7] Screen-scraping requires consumers to provide account login credentials for third parties to acquire financial and transaction data, process data requests or

[7] Treasury Report p. 25.

execute transactions.[8] This is the most flexible method for third-parties, but means that the consumer is unable to reliably control access, or grant access only to certain types of data, that the FinTech provider is required to store user credentials, and that the financial institution is unable to conclusively identify the third party and may block access, suspecting that the account is being hacked. By contrast, data aggregation through an API is based on explicit consumer consent given directly to the account provider rather than requiring login credentials. Importantly, this consent can be easily revoked by the consumer, without having to change the login credentials. Data sharing via API also generally means that the participating financial institutions are knowingly sharing data through an agreement or protocol; access is enabled through consumer consent provided to the financial institution or at the API access point.[9] Unlike screen-scraping, APIs give companies the ability to address specific issues critical to data sharing such as enhanced consumer access controls, robust security features, and transparency. They also allow the consumer to control access at a very granular level, supporting the principle of data minimization. However, account providers must voluntarily participate in the APIs, and the quality, reliability and performance of the API interface is within each provider's control. The type of data transmission that is allowable, or whether there will be one mandatory standard, will need to be determined. For access via APIs, it may be necessary to set minimum standards in terms of access, performance and reliability.

2. *Liability.* Financial institutions would benefit from guidance about whether they are expected to treat a data aggregator operating under a data sharing agreement as it would treat itself when it employs a data aggregator. Likewise, clarifications are needed about which parties are responsible for the failure to adequately protect data should be specifically dealt with in the data sharing agreements.

[8] Treasury Report p. 25-26.
[9] Treasury Report p. 26.

3. *Prescriptiveness.* The Treasury Report encourages the US to use the UK's Open Banking initiative as a potential comparison point in further developing its data aggregation regime. Under Open Banking, the UK's nine largest banks have been required to adopt open API banking standards and to make such data available. For legislators and regulators, Open Banking has underscored the importance of identifying whether – in the long term – the aims of a data aggregation regime are better achieved through enabling legislation, regulation, or simply through guidance. Such guidance might cover removing obstacles and relying upon competitive forces to achieve success. Mandatory requirements may result in more activity sooner, but may also result in a narrower and more restricted end product. Being overly prescriptive runs the risk of stifling the very innovation that it seeks to promote; on the other hand, being too general merely creates ambiguity and uneven implementation.

LICENSING AND REGULATORY FRAMEWORK

Many FinTech companies, including payments companies and platform lenders, are subject to the authority and supervision of state banking departments and other financial services regulatory agencies. Under the state regulatory regimes, FinTech companies are often required to obtain some form of state licensing and registration, depending on the product or service being offered. For FinTechs operating across multiple states that require licensing or registration, the company must conduct an expensive and time-intensive national licensing campaign, taking several months or even years.

License and registration application redundancies between the states contribute to the cost and time involved in the licensing process. For example, state applications may ask for detailed information about the company, key employees, executives and owners. Questionnaires for individuals often request detailed personal information, including background financial, residential, employment, and family history that may not be readily accessible to that individual, adding complication to the process. The information requested may also slightly vary between states, even though the objective is substantially similar. When multiplied by the number of states in which the entity is seeking licensure, these requirements quickly become time and resource intensive.

The Treasury Report identifies the state oversight and harmonization challenges faced by entities offering financial services products across multiple states in the US. Thus, it recommends creating uniformity to streamline state supervision and licensing for non-bank financial institutions, such as adopting reciprocity-type measures to help reduce redundancies in the licensing and registration process. I fully support this recommendation.

As the Treasury Report notes, ongoing efforts are underway to build efficiencies into state licensing and registration processes. The Conference of State Bank Supervisors ("CSBS") and state regulators have made meaningful developments in this regard. One ongoing effort is the expansion of financial services industries that fall within the framework of the Nationwide Multistate Licensing System ("NMLS").[10] The NMLS is a technology platform that promotes information sharing and coordination between state regulators in state license activities (applications, updates, renewals, and surrenders). From a practical standpoint, the NMLS centralizes licensing and registration processes that would otherwise be scattered amongst numerous state regulators' systems. Expansion of the NMLS will help streamline and reduce the burden of the licensing processes.

The CSBS has also launched Vision 2020, its commitment to further harmonize the state-based regulatory regime.[11] Under Vision 2020, the CSBS and state regulators are exploring passporting-like efforts among the states. Earlier this year, seven states agreed to recognize the review and acceptance by other participating states of certain application

[10] States Expand Use of NMLS to New Industries updated Jan. 1, 2018, *available at:* https://mortgage.nationwidelicensingsystem.org/news/Pages/ExpandedUse.aspx

[11] Vision 2020 for Fintech and Non-Bank Regulation, dated June 7, 2018, *available at:* https://www.csbs.org/vision2020

materials for money services businesses.[12] Further passporting or reciprocity efforts between state regulators would be welcomed by the industry.

ALTERNATIVE CREDIT RISK MODELS

As the Treasury Report identifies, lenders are finding innovative ways to evaluate the credit risk for consumer and small business credit applicants by using alternative data in their risk analysis. This type of credit risk analysis often depends on results generated from the abundance of consumer data available online, coupled with machine learning. These models vary from traditional credit risk analyses; systems not only use alternative data but employ machine-based learning to determine outcomes for future credit risk decisions. Use of alternative data and machine learning for credit risk analyses puts to use a broader range of data, including data that may be less obviously associated with creditworthiness. These systems have been recognized as potentially helping lenders make sound credit risk decisions while increasing inclusion for applicants that are often excluded from other credit models.[13] For individuals who could be a decent credit risk, but have relatively thin credit histories, alternative data modelling may open credit access.

With the potential to render more accurate and reliable indicators of credit risks than traditional models, lenders, investors, and the larger economy could benefit significantly from exploring the use of these alternative credit models. Despite the benefits, however, lenders may be reticent to develop and utilize alternative credit models because of the unknown regulatory compliance risks. In particular, they often face concerns that the use of these models will expose them to liability under anti-discrimination statutes and regulations, including the Equal

[12] State Regulators Take First Step to Standardize Licensing Practices for Fintech Payments, dated Feb. 6, 2018, *available at:* https://www.csbs.org/state-regulators-take-first-step-standardize-licensing-practices-fintech-payments

[13] In February of 2017, the Bureau issued a Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process. In its request, the Bureau acknowledged the "gaps in access to mainstream credit for certain consumer groups and segments" and the possibility that "alternative data modeling techniques" could help close these gaps and improve credit risk decisions. *See* https://files.consumerfinance.gov/f/documents/20170214_cfpb_Alt-Data-RFI.pdf.

Credit Opportunity Act and its implementing regulation, Regulation B ("ECOA").[14] ECOA liability may arise under several theories, some of which have not been tested with respect to Big Data and machine learning. Understanding more about how alternative credit models will be assessed under the current anti-discrimination prohibitions is critical for regulators to provide guidance that allows the careful development of this innovative technology.

REGULATORY SANDBOXES

Regulators and industry participants, alike, will benefit from the information obtained by testing new innovative technologies.

The purpose of a regulatory sandbox is essentially, to create an environment for firms to try out new ideas without threat of regulatory penalty. By providing this environment, regulators expect to create a range of beneficial outcomes for firms and consumers, such as:

a) reduced time to market for new products and services due to firms having greater certainty as to the regulatory treatment of those products and services;

b) better access to finance for firms seeking to raise funding for their new products and services, due to investors having greater comfort that the business will be viable from an operational and regulatory perspective;

c) the development of more innovative products, due to firms having the ability to test ideas in a supportive regulatory environment; and

d) better outcomes for consumers, due to the better quality of testing that can be applied within a sandbox environment. Also, the use of a sandbox enables the regulators to provide input on consumer protection features at an earlier stage of the product development process.

[14] 15 U.S.C. §§ 1691 et seq.; 12 C.F.R. § 1002.4(a).

In the United Kingdom, for example, the lead financial services regulator, the Financial Conduct Authority (FCA), has established a domestic regulatory sandbox which has been used as a model for other sandboxes around the world. The FCA is able to deploy the following tools to facilitate the operation of its regulatory sandbox:

a) Restricted Authorization

Where a firm wishes to conduct a regulated activity in the UK, it must be authorized by the FCA, unless its activities fall within the scope of an applicable exemption. Consequently, where a sandbox applicant's activities would involve the performance of regulated activities, it will need to apply for authorization from the FCA to perform those activities.

In order to streamline this process for firms that have been accepted into the sandbox, the FCA has developed a tailored authorization process. The authorization granted by the FCA for the sandbox applicant will be restricted so that firms may only test their ideas as agreed with the FCA. At the end of the sandbox testing period, the firm may either apply for full authorization, or its authorization will expire.

It should be noted that the restricted authorization option is not available for firms seeking a banking licence.

(b) **Individual Guidance**

The FCA is able, under its existing powers, to issue individual guidance to firms on the interpretation of the FCA rules applicable to the activities that the firm wishes to carry out. The FCA may use this power to issue individual guidance to help firms participating in the regulatory sandbox to understand the regulatory treatment of their proposed activities. If a firm acts in accordance with the guidance, it provides the firm with certainty that the FCA will not take action against it.

(c) **Waivers or modifications to the FCA's Rules**

The FCA has the statutory power to issue waivers or modifications to its rules where it is satisfied that:

(i) compliance by the person with the rules, or with the rules as unmodified, would be unduly burdensome or would not achieve the purpose for which the rules were made; and

(ii) the waiver or modification would not adversely affect the advancement of the FCA's objectives.

Consequently, where it is clear that proposed testing activities within the regulatory sandbox do not meet the FCA's rules, but the firm can meet the waiver test and the rules are within the FCA's power to waive, the FCA can waive or modify particular rules for sandbox firms. A waiver or modification allows what would otherwise be a temporary breach of the FCA's rules.

(d) **"No Enforcement Action" Letters**

In cases where the FCA is unable to issue individual guidance or waivers, but believes it is justified in the particular circumstances and characteristics of the sandbox test, the FCA can issue "no enforcement action" letters.

Such letters would state that the FCA will take no enforcement action against testing activities where they are reasonably satisfied that the activities do not breach the FCA's requirements or harm its objectives. The letter would apply only for the duration of the sandbox test.

Provided that the firm deals openly with the FCA, keeps to the agreed testing parameters and treats customers fairly, the FCA accepts that unexpected issues may arise and would not expect to take disciplinary action.

TRUE LENDER/VALID WHEN MADE

In my opinion, a handful of court decisions have wrongly called into question whether the bank is the "true lender" in a bank-fintech company partnership even if the bank extends the credit according to underwriting criteria it has approved, is included as the lender in the loan agreement, and holds the loan for some time after the loan is made. These court decisions are based on a "predominant economic interest" test that is subjective and that can be cited to conclude that the fintech company is the true lender in these circumstances. Whether the bank or fintech company is the true lender may be the difference in determining whether the loan is void or uncollectible, meaning that the lender may not be able to recover its principal, much less its costs and profit, depending on the court's "true lender" analysis. This uncertainty is having a chilling effect on innovation in the United States. To address this uncertainty, Congress should consider legislative language making clear that the bank is the "true lender" in these partnerships when it is extending credit.

A related but separate issue is the "valid when made" doctrine, which is a bedrock principle of lending in this country that was eroded by the court's decision in *Madden v. Midland Funding*[15]. In Madden, a loan originated by a bank was charged off and sold by the bank to a debt buyer. The debt buyer argued that because the loan was valid when it was made by the bank, any fees that could be charged by the bank under its governing statute also could be charged by the debt buyer. The court disagreed and held that the terms of the loan were now governed by the relevant laws applicable to the debt buyer and therefore invalid in the hands of the debt buyer. The court's decision is a problem not just for bank-fintech partnerships but for the U.S. credit markets more generally. To restrict the transferability of loans in this way is to prevent fintech companies from purchasing and attempting to collect on, sell, or securitize loans made by banks in these states because of the risk of litigation asserting violations of state usury

[15] *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015).

laws. Congress should consider legislative language restoring the "valid when made" doctrine so that loans are freely transferable and the terms and conditions that applied when the loan was made remain intact, thereby preserving active credit markets in the US and facilitating the innovation that results from banks and fintech companies partnering together.

CONCLUSION

The Treasury Report is a very good start and I commend the Treasury Department on its publication. I would urge Congress to work together in a bipartisan fashion to address the recommendations that fall within Congress' purview. The US cannot fall behind other countries and so we must ensure we have clear rules of the road and right now that is not the case.

Appendix

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Fintech in the U.S.: The state of the union is questionable

Written by Aaron Cutler and published by FinTech Futures

05 Apr 2017

This is the first in a series of three articles by *Hogan Lovells' partner Aaron Cutler* and *associate Loyal Horsley* discussing the regulation of the fintech industry in the US.

This first article provides an overview of the current fintech regulation by the prudential regulators: the OCC, the FDIC, and the Federal Reserve.

The second instalment addresses the views of the Department of Treasury, the CFPB, and the SEC on the regulation of the fintech industry. The third one looks at state-level fintech regulation, proposed legislative solutions, and provide a brief overview of international regulation.

With President Donald J. Trump, it is difficult to predict how the legislative and regulatory landscape will change, but we expect a lighter regulatory environment. On 3 February 2017, President Trump issued an executive order laying out his core principles on financial regulation and mandating a review of current and proposed regulations with a view to their compatibility with those principles. Secretary Mnuchin will provide a report to President Trump in June providing his and the agency heads' analysis. Fintech has been an area of exciting innovation and regulatory interest, it remains to be seen how it will evolve under this new administration.

"Fintech" is a portmanteau of financial and technology and refers to the vast swath of emerging financial products and services relying on new technology. These include, but are not limited to, marketplace lending (like Prosper or Lending Club), online banking, Bitcoin and blockchain technology (also known as distributed ledger technology or DLT), money management apps (like Mint), and money transmitters/digital wallets (like Venmo and Paypal). Because of their increased availability and utility, state and federal financial regulatory agencies and state and federal legislatures have taken notice of fintech products, services, and companies. There is discussion of whether fintech should be integrated into current laws and regulations or should be specifically addressed in new laws and/or regulations.

The federal regulatory landscape

Because it is new technology, there is not a defined regulator for fintech. At the federal level, there are many agencies that deal with financial regulation, these include the Department of the Treasury, the Office of the Comptroller of the Currency (OCC), the Consumer Financial Protection Bureau (CFPB), the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (FRB or the Fed), the Securities and Exchange Commission (SEC), the Commodity Futures Trading Commission, the National Credit Union Administration, and the Federal Trade Commission.

The OCC, FRB and FDIC are considered prudential regulators because they focus on the safety and soundness of an institution, as well as the entire financial system. Because many fintech companies are partnering with banks in order to avoid expensive regulatory compliance costs, usually on the state level, the prudential regulators want to ensure they understand the marketplace and the risks posed by these new entrants. This article will focus on the prudential regulators' roles in regulating the fintech industry.

A growing role for the OCC

The OCC is the primary regulator for all national banks and federal savings and loan associations and it has been among the most proactive in addressing the concern of regulating a growing fintech industry. In December 2016, the OCC announced it was moving forward with its rather audacious plan to use its chartering authority to provide special purpose charters to fintech companies engaged in the "business of banking." The proposal sets out the OCC's chartering authority and provides a general outline of the initial and ongoing requirements for receipt of this charter. These requirements include capital, liquidity, and "financial inclusion" (which is the OCC's term for Community Reinvestment Act – CRA – type requirements).

While capital and liquidity requirements may deter some fintech companies from pursuing a charter, the most potentially burdensome requirements are those related to financial inclusion. As the CRA is only applicable to FDIC-insured institutions, it would likely not cover most OCC-chartered fintech companies. CRA compliance and applicability is already an issue for banks that do not have any brick and mortar branches (digital-only banks) – the CRA is enforced by looking at the bank's lending, investments, and services in the communities where they have branches.

The CRA requires banks to be examined and graded by their prudential regulator to monitor the bank's activity in low- and moderate-income neighborhoods that are traditionally underserved by lenders. Regulators adjust their examination based on the bank's size, with those institutions with more than $1 billion in assets receiving the most rigorous exams; intermediate banks (between $250 million and $1 billion in assets) and small banks (less than $250 million in assets) have successively less robust exams. The examiner reviews the bank's lending portfolio and determines the percentage and number of loans made to low- and moderate-income borrowers; examiners also review the percentage and number of accounts at the bank belonging to low- and moderate-income customers.

Importantly in this context, one of the guideposts for showing service to low- and moderate-income communities is the number and location of a bank's branches in those communities. If a bank has no branches, how can examiners measure whether it discriminates against those areas it serves? If a branch is no longer a requirement to be a bank, the CRA will have to be retooled to continue being effective. Currently, some banks are partnering with marketplace lenders to help with their CRA statistics because online lenders are able to reach a wider swath of borrowers. These partnerships are potentially at risk, depending on the OCC's determination of what CRA-like requirements will apply to its chartered fintech companies.

While the comment period on the special purpose charter just ended on 15 January 2017, the OCC has approved the creation of "Offices of Innovation" in Washington, DC, New York and San Francisco. The hope is that fintech companies will reach out to these offices and discuss their products and services with the OCC prior to launching them, so that the regulator can assess potential consumer harm and help the fintech company understand the laws and regulations that may be applicable to the proposed product or service. If the fintech company is able to integrate the OCC's advice into their business model, including a mutual understanding of its compliance obligations, it will hopefully allow for a better consumer experience and provide both the business and the regulator with a robust understanding of how the company fits into the larger financial services landscape.

The Federal Reserve (FRB, the Fed)

The Fed does not directly regulate any of the entities currently involved in fintech, but it does control the US payment systems. As such, the FRB has a special interest in DLT and its potentially transformative presence in payment and settlement systems. In October 2016, the it announced its two task forces (one focused on faster payments capabilities, the other on payment system security) had begun review of proposals and assessments submitted by interested parties throughout the payments industry.

Their findings will be issued in a two-part report with the initial report published on 26 January 2017. The first report provided an overview of the task force's background, its processes, the benefits of faster payments, and the current US payments landscape.

In December 2016, the FRB released its long awaited report, "Distributed ledger technology in payments, clearing, and settlement" (FRB Report). The report reviewed the current payment, clearing, and settlement systems and provided its view of the potential opportunities and potential pitfalls for the integration of DLT into these systems. To compile the FRB Report, the team worked with industry leaders, in both banking and DLT to better understand both the "frictions" present in the current systems and the potential of DLT.

The report allows that DLT "could reduce or even eliminate operational and financial inefficiencies", but stresses the technology is in its infancy. Theoretically, DLT has the capability to seriously cut down the threat of large scale hacking and theft of information because it lacks a centralized database with the stored information. In addition, if DLT is going to be useful and transformative, it will have to adopted on a large scale rather than in a piecemeal fashion. Overall, the report agrees that DLT has exciting promise, but it is unlikely to revolutionise payments, clearing, and settlement systems in the very near future.

The FDIC protects, defends and burdens the banks

The FDIC has only has oversight over FDIC-insured institutions and is the primary federal regulator for all state-chartered insured depository institutions. Therefore, it does not regulate most of those industry participants typically included under the fintech umbrella. Banks, themselves, are entering the fintech "playground" and their activities would be covered by the FDIC, but most fintech activities at banks is happening through their relationships with third parties.

With that in mind, the FDIC released its proposed Third Party Lending guidance in July 2016 (Proposed Guidance). It focuses on bank relationships with third party lenders, which mainly consists of online marketplace lenders. FDIC-insured institutions are incentivized to enter into relationships with marketplace lenders because it allows them to reach a wider potential audience and can pad the bank's portfolio with regard to its obligations under the CRA.

The FDIC warns, however, that the bank's board of directors and management are ultimately responsible for the activities of any third party with which it has a relationship. Therefore, the Proposed Guidance details the sort of risk assessments and ongoing compliance oversight a bank must conduct prior to entering, and throughout, a relationship with a third party lender.

In addition, the FDIC has stated it will evaluate the third party's activities as if they were being conducted by the bank, itself. That means the bank must have enough capital and liquidity to properly safeguard against the increased risk of third party loans. The bottom line is, banks are allowed to enter into third party lending relationships, but they will be subjected to increased scrutiny from the FDIC. Because the Proposed Guidance is from the FDIC, it would only be applicable to state-chartered banks that are not members of the FRB. The OCC and FRB, however, may well take cues from the FDIC.

The comment period on the Proposed Guidance ended in October 2016. While one would usually expect a final rule by probably mid-2017, the new administration has staked out a distinctly anti-regulation point of view. While the Proposed Guidance does not really create additional regulations, it does strengthen the FDIC's oversight of any bank with third party lending relationships, which the Trump administration may view as inappropriate and overly burdensome.

What's next?

While a light regulatory touch is usually the preferred system for start-ups and innovation, in financial services that often breeds more confusion than capital. It has long been understood that banks are special – deposits are backed by the full faith and credit of the United States Treasury and banks provide the lubrication for our entire financial system, and therefore the safety and soundness of the U.S. and global economy. This responsibility can make people wary to enter the financial services sector without proper direction from regulators. At the moment, the prudential regulators are poised to offer guidance and new opportunities to fintech businesses, but the future is uncertain.

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U.S. fintech regulation: A divided picture at the federal level

Written by Aaron Cutler and published by FinTech Futures

12 Apr 2017

***Hogan Lovells' partner Aaron Cutler* and *associate Loyal Horsley* address the views of the Department of Treasury, the CFPB, and the SEC on the regulation of the fintech industry in the US.**

This is the second in a series of three articles discussing the regulation of the fintech industry in the US.Click here to read the first article, which provides an overview of the current fintech regulation by the prudential regulators: the OCC, the FDIC, and the Federal Reserve.

While the prudential regulators are testing the waters in fintech regulation, other federal agencies have also focused on fintech's potential, both as a disruptor and as a potential market infrastructure tool. Marketplace lending has been a topic of regulatory and industry conversation for the last several years.

Currently, marketplace lending is attempting to fill gaps still left in credit availability after the financial crisis, especially in small dollar small business loans. In this case, small dollar means $250,000 or less. Community banks have generally provided the lion's share of small business and agriculture loans in the US, but the financial crisis and the response to it both eliminated many community banks and created a credit crunch. Marketplace lenders have stepped up to fill in the resulting gaps for both small business and personal loans. While the first generation of marketplace lenders tended to be distinct, separate entities, many are now partnering with banks. Marketplace lenders are not the only ones: money transmitters are exploring bank partnerships in order to avoid costly and time consuming fifty state licensing solutions.

The Department of Treasury oversees the entire US financial system and economy and is a guiding force when it comes to regulatory scrutiny.

The Securities and Exchange Commission (SEC) regulates the primary and secondary markets of the US and safeguards consumers in that space. A recent expansion of the rules on raising capital online, as well as the entry of new players, such as online marketplace lenders, in the mortgage securitisation space has implicated the SEC's involvement in fintech, which will likely only grow as fintech expands its footprint.

The Consumer Financial Protection Bureau (CFPB) regulates consumer financial products and services, which covers most of fintech's new and exciting tools. The CFPB has direct supervision over financial institutions with $10 billion or more in total assets. Each agency has taken an interest in the growing role fintech is playing in the U.S. and international financial systems.

Treasury takes notice

In May 2016, Treasury released a white paper entitled "Opportunities and Challenges in Online Marketplace Lending" and has sent representatives to speak at several conferences on the topic of marketplace lending. The white paper was drafted as a follow-up to Treasury's request for information (RFI), "Public Input on Expanding Access to Credit through Online Marketplace Lending", which was issued in July 2015.

Treasury received about 100 responses to its RFI and the white paper is generally positive about the potential for online marketplace lending to expand access to credit. Treasury offers its view of the RFI responses and provides some advice and recommendations for moving forward in this space. It found that online marketplace lending has expanded access to credit, especially small businesses, though the majority of the loans originated were for consolidating debt. The expansion of data used for underwriting was one of the more exciting innovations by online lenders and is being adopted by a larger segment of the financial services industry. However, these "data-driven algorithms" do not provide the borrower the opportunity to correct information and they may result in fair lending violations and disparate impacts. It's really too early to determine the impact, but the expansion of data and modeling are an area on which Treasury will continue to focus. In addition, online marketplace lending has emerged in the low cost of credit environment during the Obama years; these lenders have not been properly tested during a higher cost of capital environment.

Small business' access to credit has been a big focus in the last few years. Many RFI responders drew attention to the relative lack of financial protection for small businesses. The Obama years have seen an immense focus (at both legislative and regulatory levels) on consumer protection, exemplified by the creation and expansive authority of the CFPB (which will likely be narrowed by Congress and the Trump Administration).

However, small businesses do not enjoy the same level of oversight and protection. Clearly, small businesses do not uniformly want increased regulatory oversight, but offering enhanced protections for small businesses in terms of consumer-like disclosure and reporting obligations were generally favored by the commenters. Some consumer advocates argued that small businesses should be treated as consumers for lending purposes. Considering people often have different definitions for what constitutes a small business, this treatment seems rife with potential misuse and unlikely to survive legislative or regulatory muster.

Finally, the white paper reviews the secondary market for loans originated by online marketplace lenders. Securitization of these loans is not well developed at the moment and will require further regulatory guidance. The SEC is reviewing the implications of online marketplace lenders selling loans into the secondary market.

Fintech in the markets

The SEC is also getting into the game on fintech. It has established a Distributed Ledger Technology (DLT) Working Group to investigate the new technology and its potential uses and abuses. Further, the SEC is looking at the growing field of crowdfunding, both its Regulation Crowdfunding equity crowdfunding model and others, including debt crowdfunding. In addition, the marketplace lending market, especially securitisation of loans, is of particular interest to the SEC.

Acting Chairman Piwowar is especially interested in promoting fintech and the SEC's role as regulator and ally to the growing industry; he championed the SEC's Fintech Forum, which was held in November 2016. The Fintech Forum reviewed robo-advisors, DLT, new paths for capital formation, and investor protection. Robo (or digital) advisors are increasingly common and are often used by individuals with smaller investments who either cannot afford an investment advisor or would like to supplement that advice. Digital advisors' assets under management are projected to reach $2.2 trillion by 2020.

The panel participants stated their view of the future is that this becomes just "investment advice" rather than "digital investment advice" as humans would lean on algorithms and computing power to give investment advice anyway. The future of investment advice does not appear to be solely computer-based, but will certainly be an intricate blend of algorithmic and experienced-based advice, which would likely trigger the Investment Advisers Act of 1940's provisions requiring registration (Section 203) and compliance with a fiduciary standard (Section 206, as understood by the Supreme Court in *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963)).

Capital formation for small(er) businesses was an ongoing preoccupation for the Obama administration and the Republican Congress, which signed the bipartisan JOBS Act in 2012. One of the most exciting provisions of the JOBS Act was the advent of SEC-regulated equity crowdfunding, which allows businesses to offer securities over the internet. Its main utility is for small businesses, since it limits offerors to raising $1 million per year. This is an example of simple fintech: a tool providing a new route to capital for small businesses that would not be able to conduct an IPO or have access to venture capital. Regulation Crowdfunding, 17 C.F.R. § 227.100 et seq., became effective 16 May 2016 and has so far been a great success, according to the SEC.

Blockchain/DLT is one of the only truly new innovations and its use for traditional financial services, as well as other industries, is still being discussed. However, some organisations are forging ahead with its use. For instance, Sydney Stock Exchange has revamped its settlement system, and so has its larger competitor Australian Securities Exchange (ASX), which is expected to start using blockchain later this year. Both stock exchanges believe the new technology will drive down costs, increase efficiency and transparency, and decrease risk.

One of Switzerland's largest market infrastructure providers, SIX Securities Services is currently working on a proof-of-concept (PoC) to integrate blockchain into the Swiss financial system.

In the US, Cook County, Illinois, is currently running a pilot program to use blockchain to transfer and track property titles and other public records. The Cook County Recorder's Office is the second largest in the US, so the adoption and success of a DLT system there would likely encourage other states and counties to use the technology.

On top of DLT, the advent of "smart contracts" has the ability to change payments drastically. A smart contract is an autonomous program that directs money without human interference according to an algorithm. An example: if an investor is willing to provide funding to a start-up, but only if they reach a certain capital threshold; they can execute a smart contract that will automatically go into effect upon the start-up reaching that threshold. The parties will not need to discuss it further or provide any instructions after the original agreement.

This sort of tool could simplify complex payment agreements in many spheres. For example, in a farmer's drought insurance agreement, the parties could agree that after 15 days of zero rain, as recorded by the National Weather Service in the farmer's zip code, the insurance company would make a certain payout without the farmer having to make a claim.

DLT and smart contracts are also being discussed in the healthcare industry, as a way to keep up with patient records. In both the health care and financial services sector, the biggest potential issues are privacy and security, which must be adequately addressed before DLT can be used for mass market record-keeping.

The CFPB, fintech and the future

The CFPB has been among the most active agencies in engaging the fintech industry. Because so much of financial innovation does not fit within the bailiwick of "banking" or even the broader "business of banking", but is certainly a consumer financial product or service, the CFPB is the relevant federal agency. In this role, it has undertaken "Project Catalyst," which encourages "consumer-friendly innovation in markets for consumer financial products and services".

One of its major "outreach" efforts is the new no-action letter policy, which encourages fintech companies to reach out to the CFPB by providing information regarding their product or service and their understanding of the compliance requirements. By providing a no-action letter, the CFPB is indicating it believes the company is in compliance with the relevant laws and regulations and the CFPB is not going to file an enforcement action so long as the company does not make material changes.

While the CFPB's policy is quite friendly, its no-action letters are not binding on other agencies, so that leaves a fintech company vulnerable to the determination, by another regulator, that it is not in compliance with all relevant laws and regulations. This is obviously true of any agency's no-action letter, but considering most of the federal financial regulators are having trouble deciding what to do with fintech, many companies may decide not to take the chance of relying on the CFPB's say-so. Again though, regulating by No-Action Letter is much less desirable than actually going through the Administrative Procedure Act-mandated rulemaking process.

The CFPB did recently release its long awaited Prepaid Card Rule, which provides a very broad definition of "prepaid card" that encompasses mobile wallets, like Google Wallet and Paypal, where you can not only send money, but also store it. Money transmission is moving money from one place/person to another, and while Paypal and Venmo provide that service, they also allow users to keep money in the app rather than transfer it to their bank account. This service places them within the scope of the CFPB's new rule.

Mobile wallets are one of the more exciting and popular recent innovations, splitting the bill at dinner or having multiple friends purchase a present has never been easier now that everyone can transfer funds quickly and for free. Considering their popularity, the CFPB likely felt compelled to provide consumer protections where there may be a need, but this sort of rule could cut down on start-ups entering this space as they would have to hire experts and attorneys to ensure compliance and avoid potential enforcement actions.

The CFPB is likely the most vulnerable agency in a Trump government. Its broad mandate and limited congressional oversight has made it a target of Trump and Congressional Republicans. While it is incredibly unlikely the CFPB would actually be dismantled, its structure and leadership will almost certainly change, likely relatively early in President Trump's term. The Court of Appeals for the D.C. Circuit's recent decision in PHH Corporation, et al. v. Consumer Financial Protection Bureau found the current structure of the CFPB is unconstitutional.

However, the court provided a simple fix: the president can now remove the Director of the CFPB at will, rather than only for cause. The D.C. Circuit granted an en banc rehearing on 26 February 2017 and oral arguments began in March. Due to the rehearing, the previous order is on hold pending the rehearing. A rollback of current regulations and policies will be difficult to enforce, but the uncertainty may further discourage fintech innovators from working with the CFPB.

States are also involved in regulating fintech and their role may grow if President Trump follows through on his early moves to cut down on federal regulation. Several states, including New York, which is very influential in financial services regulation, have stated their goal of stepping into any federal void created by regulatory rollback. In addition, Congress is focused on both financial regulatory reform, in general, and fintech-specific legislation. The new Congress and President Trump's terms have barely begun, so their effect on the fintech industry remains to be seen.

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Fintech in the U.S.: Where is regulation headed

Written by Aaron Cutler and published by FinTech Futures

19 Apr 2017

***Aaron Cutler, partner, and Loyal Horsley, associate at Hogan Lovells,* examine the state-level fintech regulation, proposed legislative solutions, and provides a brief overview of international regulation.**

This is the third in a series of three articles discussing the regulation of the fintech industry in the US. Click here to read the first instalment (an overview of the current fintech regulation by the prudential regulators: the OCC, the FDIC and the Fed). Click here to read the second article, which addresses the views of the Department of Treasury, the CFPB, and the SEC on the regulation of the fintech industry.

As discussed in earlier articles, fintech regulation is unsettled at the moment. Federal financial regulators are all addressing fintech issues in different ways and the efficacy of some approaches remains to be seen. In order to ensure consumer protection, while also encouraging innovation and, hopefully, spurring economic growth, both state regulators and the federal legislature have also stepped into fintech oversight.

State rules and regulations

While federal regulators and legislators have spent many months working to find solutions to address this growing industry, states have also been working hard to encourage "responsible innovation" in the fintech industry. Much of the innovation in fintech is really in the delivery system, rather than the product itself. More often than not, fintech is just speeding up the process for services, such as transferring funds. Because of that, the state-level money transmitter licensing schemes are well-positioned to regulate much of the burgeoning fintech industry.

While it's a point of contention, and some states are working on separate frameworks to address it, even the most "exciting" fintech innovation – virtual currency and blockchain technology – often falls under this regulatory regime. Money transmission is defined by each state, but the general idea is that a company transmits or converts money. This definition captures many of the fintech businesses making waves at the moment and simplifying/speeding up this process is the focus of many of the innovators.

Money transmitters, or money services businesses, operating across state lines (which is almost impossible not to do in the age of the internet/smartphone) must be licensed in each state in which they operate (except Montana, which does not currently have a licensing requirement), which is an expensive proposition. New York, Connecticut, North Carolina, and Washington have drafted licensing requirements specific to virtual or digital currency, just to name a few. The Uniform Law Commission is finalizing the Regulation of Virtual Currency Businesses Act, in the hopes of streamlining states' virtual currency regulation. The drafting committee met in March 2017 to review and revise the current proposal.

Banks, of course, provide money transmission services and are not required to be separately licensed to do business in this space, which leads to many partnerships between banks and fintech companies – and to the reason the banking agencies are desperately trying to address this industry.

Proposed legislative solutions

The most comprehensive legislative proposal addressing this industry currently on the table is Rep. Patrick McHenry's (R-NC) Financial Services Innovation Act of 2016. The bill was introduced as part of the House Republicans Innovation Initiative, led by Majority Leader McCarthy (R-CA) and Rep. McHenry, which has the stated goals of "fostering innovation to spur greater economic growth and to bring our government into the 21st century".

The Financial Services Innovation Act proposes to create a Financial Services Innovation Office (FSIO) within the CFPB, CFTC, FCA, FDIC, FHFA, FRB, FTC, HUD, OCC, NCUA, SEC, and Department of Treasury. Recognising that fintech and financial innovation may not touch all of those administrative agencies, it has a sunset provision, meaning that if the FSIO in an agency has not received a petition in five years, it will be eliminated.

To coordinate between the various agency FSIOs, there will be the FSIO Liaison Committee to ensure uniformity of standards and advice throughout the FSIO system.

The main point of the FSIO (and the Financial Services Innovation Act more generally) is, similar to the OCC's Offices of Innovation, chiefly to encourage those with interesting and innovative ideas to come to the regulators to try to ensure a compliant product or service.

A fintech provider files a petition with the relevant agency in which the petitioner provides an "alternative compliance strategy" for its product or service and shows the regulator that this strategy would serve the public interest, increase access to financial products and services, promotes consumer protection, and does not present a systemic risk to the financial system. Upon receipt of a petition, the chosen agency must review it and provide for public comment. If the petition is approved, the agency and fintech provider can enter into an "enforceable compliance agreement," in which the agency may waive certain of its regulatory requirements and prohibits other federal agencies and states from commencing enforcement actions against the protected fintech provider. This proposal echoes the "fintech sandbox" approach of some other governments, discussed below.

This bill is still in its infancy, legislatively speaking, and will likely be heavily modified, especially the enforceable compliance agreement's moratorium on enforcement actions. However, with a Republican president and Republican Congress, it may have a chance of passing. While President Trump has railed against increased regulation, the McHenry bill provides for the elimination of any offices that aren't used, increases public interaction with regulators, and essentially forces the regulators to embrace and encourage new and innovative fintech products and services, so the new administration may view it favourably.

While the proposed legislation and regulations address the current state of fintech and will likely be helpful in the near future, there are several unaddressed potential issues.

First and foremost would be the potential of a non-bank fintech company to become a non-bank systemically important financial institution (a non-bank SIFI) under the Dodd-Frank Act, as determined by the Financial Stability Oversight Council. While currently that may seem sort of silly, if, for example, Google or Apple or Facebook became an active player in the financial services sector, they could easily overwhelm the competition and become an essential player in the market. The non-bank SIFI designation is required for those non-bank financial service providers whose failure could potentially trigger a financial collapse. Because of some tech companies' ubiquity in our daily lives, their collapse could absolutely have a contagion effect on the financial services industry. Currently, the regulatory burden of entering into the financial services industry (likely along with other considerations) has kept these technology giants out of it, but the basic tenets of capitalism suggest that if they had the right product or service, they would enter the fray. Chairman Jeb Hensarling (R-TX) and other Congressional Republicans have introduced legislation to take away FSOC's authority to designate non-bank SIFIs. The removal of that authority could lessen the potential pitfalls of a big tech company entering this space.

A global perspective on US fintech regulation

Perhaps surprisingly, the U.S. is not the leader in addressing fintech's place in regulated financial services. In the UK, the Financial Conduct Authority (FCA) has authorised a "fintech sandbox", which allows companies, both start-ups and current players, to provide the product or service to a limited consumer audience before requiring regulatory compliance/ licensing, as applicable. On the one hand, this encourages innovation and allows beta testing of new products and services; consumers can be exposed to the cutting edge of fintech and decide whether or not products and services are useful to them. It does, however, increase the chance of consumer harm. This programme only went live in May 2016, so we have yet to get to see how well it works.

Both Singapore and Hong Kong have also decided to adopt the "sandbox" approach.

The Bank of Canada, Canada's central bank, recently experimented with digital currency, creating the CAD-Coin and running a pilot programme with several large financial institutions. While the Bank of Canada has stated it has no plans to actually issue a digital Canadian dollar, its experimentation with virtual currency and its report issued in August 2016 shows the momentum and increased acceptance of virtual currency. Similarly, the Bank of England is reviewing the possibilities of digital currency and blockchain technology.

Onward!

As it stands, a start-up with an innovative proposal for a financial product or service could easily be completely lost in the current quagmire of federal and state laws, regulations, and proposed solutions. Some either forge ahead without an understanding of current and potential compliance responsibilities, which could be harmful, both to consumers and to the company. Others try to gain an understanding of what rules are applicable to their product or service and lose momentum or faith due to the overlapping regulations and the large gaps facing the fintech industry.

On the one hand, the general proposals for deregulation may allow fintech companies to go to market earlier in their lifecycle, but it may also increase the potential for consumer harm, not to mention potential enforcement actions. The US is full of people with innovative ideas that may change banking and financial services entirely and the regulators are trying to have an open mind and a ready ear.

It remains to be seen if the "disruptive" politics of President Trump will hasten or stall this tenuous march toward acceptance. His "America First" worldview may lend itself to the US becoming the leader in fintech by establishing clear rules of the road, so fintech companies can prosper while ensuring the safety and soundness of the US financial system.

Written Testimony of Dion Harrison,
Director of Bank Products at Elevate
Before the House Committee on Financial Services Subcommittee on Financial Institutions and Consumer Credit
September 28, 2018

Chairman Luetkemeyer, Ranking Member Clay, and members of this House Subcommittee, thank you for the opportunity to appear in front of the Financial Institutions and Consumer Credit Subcommittee hearing today on the subject "Examining Opportunities for Financial Markets in the Digital Era."

My name is Dion Harrison, and I am the Director of Bank Products at Elevate. Our company is an innovative provider of tech-enabled credit products for non-prime consumers. I have over 20 years of experience in the consumer credit industry working for traditional banks, minority banks, and financial technology companies. My experience tells me that the partnership between Fintech companies and banks are the key to building safer, more accessible, and inclusive financial products.

Elevate takes a unique approach to deeply understand our customers, using more comprehensive data than other industry participants. I'm proud to work at Elevate because of our genuine mission to seek out good customers in disadvantaged circumstances today and provide products that help them have a better tomorrow. We're acting on our mission by infusing advanced technology and customer insights into the banking mainstream. Our products are helping the 160 million Americans with sub-700 credit scores get on a path to financial progress in several distinct ways.

We're the only Fintech company to cap our profits to reduce costs for our customers. We've lowered our APRs by over 50 percent since 2013, and we've saved consumers more than $4 billion versus what they would have paid with a payday loan.[1] We have a customer-centric approach to designing and underwriting all of our products, prioritizing direct, often technologically-driven interactions with our customers. We've also created a research institution called the Center for the New Middle Class (CNMC)[2] to better understand and educate the public on the behavior, attitudes, and challenges of non-prime consumers. Their story has been painfully misunderstood, their needs have been underserved, and their financial knowledge has been underestimated; the CNMC has set out to change these perceptions.
The CNMC has uncovered interesting trends that provide new perspectives on non-prime borrowers' experiences. two studies from Elevate's CNMC found that African Americans and

[1] Elevate Credit Announces Second Quarter 2018 Results (July 30, 2018), https://www.elevate.com/newsroom-article.html?article=elevate-credit-announces-second-quarter-2018-results
[2] Elevate's Center For The New Middle Class, www.newmiddleclass.org

women are disproportionally in a position of financial stress compared with other groups. [3] One of those studies also found that even prime African American borrowers are 80 percent more likely to live paycheck to paycheck and 28 percent less likely to have $1,200 for a financial emergency.[4] Our most recent study provided a more mixed picture for Hispanic non-prime borrowers. They are more likely to experience higher levels of employment and less volatile income, but fewer than one in ten non-prime Hispanics have a retirement account. [5]

As members of this subcommittee know, we are still recovering from the events that took place 10 years ago as our nation faced the worst financial crisis since the Great Depression. In the months and years following those events, traditional financial institutions abandoned the business of small-dollar consumer lending, reducing the credit available to non-prime consumers by over $140 billion.[6] Partnerships between traditional banks and Fintech companies are helping restart the flow of lending to these millions of Americans. Simply put, these partnerships are essential for non-prime borrowers.

Our industry is making progress, but the current consumer credit market leaves far too many people behind. This trend hurts everyone – and is especially damaging for minority communities, who were disproportionately affected by the financial crisis due to the decline in housing prices, as recently noted by Representative Meeks.[7]

To build a safer, more inclusive financial system, we should focus on three guiding principles:

1. *Regulation should be pro-consumer and enable innovation:* As Representative Meeks recently articulated, technology can level the playing field and create new opportunities by expanding access to financial services.[8] We also believe in that opportunity, and we subscribe to the intended sentiment of Rep. Cleavers' published "Principles for Fintech Lending": Be Honest and Transparent; Be Accountable; Be Fair; and Be Inclusive.

   To bolster the industry's success and safeguard consumers, we need a pro-consumer regulatory environment that is also pro-innovation. That's why we supported the BCFP's

[3] Elevate's Center For The New Middle Class, Precariousness of Non-prime Women: A Societal Crisis (June 2018), https://www.newmiddleclass.org/media/filer_public/8f/c4/8fc41242-0ecd-4d97-9c08-4f4dd6edfcfa/women_cnmc_study.pdf

[4] Elevate's Center For The New Middle Class, African American Financial Experience: Prime and Non-prime(February 2018) https://newmiddleclass.org/african-american-financial-experience-prime-and-non-prime/

[5] Elevate's Center For The New Middle Class, Hispanic Financial Experience: Prime and Non-prime (September 2018) https://www.newmiddleclass.org/media/filer_public/94/3f/943fca2f-0bf0-498b-a18a-9b464de67e6d/hispanic_201808904.pdf

[6] Elevate's Center For The New Middle Class, Non-prime Americans: The Scourge of Unexpected Expenses (January 2017) https://newmiddleclass.org/nonprime-americans-scourge-unexpected-expenses/

[7] Bloomberg Next.Tech, "A Moderated Discussion With Representatives," https://about.bgov.com/event/fintech2018/

[8] Rep. Gregory Meeks, A Moderated Discussion With Representatives, Bloomberg Government (September 2018), https://about.bgov.com/event/fintech2018/

payday lending rule – to my knowledge, we are the only Fintech lender to do so. And while there are aspects of the current regulatory system that are working well, Congress can best foster innovation by maintaining and facilitating increased stability in small-dollar credit markets.

2. *Encourage partnerships between banks and Fintech companies:* I have seen firsthand the need for technology and innovation at community banks, because it can lower rates, provide greater transparency, and deliver superior convenience for customers. Partnerships will also bolster community banks, providing them a new avenue to serve their customers. And this idea has bipartisan support, members across the aisle are co-sponsoring legislation which would enable these partnerships, including: Chairman of this Subcommittee Representative Luetkemeyer, Representative Meeks, Representative McHenry, Representative Cuellar, Representative Peterson, Representative Pittenger, Representative Sires, and Representative Sessions. Regulators and other lawmakers should clarify the legality of these partnerships, by passing bills like H.R. 4439[9] and S. 1642.[10]

3. *Embrace diversity:* It's no secret the financial services sector has been slower than other industries to diversify its workforce. Elevate has embraced diversity, and we believe this diversity reflects the non-prime customer base we serve and enables us to provide consumers with meaningful and relevant credit products, and service that's flexible enough to improve their financial lifestyles.

Fintech Companies Are Powering a Wave of Consumer-Focused Financial Innovation and Progress in the United States

Just a decade ago, when the first smartphones entered the pockets of Americans, it would have been hard to imagine their ability to empower consumers and catalyze the development of the rapidly evolving sector known today as "Fintech." Combine the smartphone revolution with the fact that at the end of 2017, more than 3.6 billion people have access to the internet, and it is no surprise the rise of Fintech has been so pronounced.[11]

Fintech companies are delivering safer, more transparent, and more convenient financial services and products to meet consumers' demands for simple solutions that address common yet complex financial situations of American families.

[9] H.R.4439 - Modernizing Credit Opportunities Act https://www.congress.gov/bill/115th-congress/house-bill/4439
[10] S.1642 - Protecting Consumers' Access to Credit Act of 2017 https://www.congress.gov/bill/115th-congress/senate-bill/1642
[11] Mary Meeker, Internet Trends Report (May 30, 2018), https://www.kleinerperkins.com/perspectives/internet-trends-report-2018

We are responsibly filling gaps left behind by traditional financial institutions following the contraction in credit after the financial crisis, and we are addressing broader needs for financial solutions. Our peers across the Fintech industry are doing the same, meeting consumers' needs for short term consumer loans, small business loans, payment solutions, and financial education with innovative technology. For example:

- *Short-term lending:* Elevate and one of its bank partners introduced Elastic, an online emergency line of credit product for non-prime consumers five years in advance of the 2018 Federal Reserve report that estimated forty percent of Americans would not be able to handle a $400 emergency expense;[12]
- *Small business lending:* Companies like Square and Kabbage are using new technology to make smarter and better small business loans;
- *Payments:* New payment platforms like Zelle and Venmo are rapidly changing the peer-to-peer payments world;
- *Financial decision-making and wellness tools:* New apps and expenditure monitoring technologies are providing consumers more real-time information and helping nudge consumers towards making smarter financial decisions.

The past few years demonstrate the tremendous opportunity and promise Fintech has to empower smaller community banks without expertise in underwriting the non-prime consumer to reach a broader consumer base and help non-prime consumers gain more control over their financial circumstances. We are confident this momentum will continue to build.

As with any emerging industry there will be staunch supporters and fierce critics. I'm confident through transparency, honesty, and results, Congress will see that leveraging the strengths of banks and Fintech companies is a powerful and positive solution to promote the innovation of solutions available for your constituents who are non-prime consumers.

As I mentioned previously, we have recently seen momentum in discussions on policy that will help address some of the regulatory barriers and challenges facing the Fintech industry. We believe supporting responsible Fintech innovation should be a bipartisan resolution for lawmakers. Our industry needs a regulatory environment that supports innovation and collaboration, while clarifying the applicable and relevant guidance.

In July, when the United States Department of Treasury released its report on: "Nonbank Financials, Fintech, and Innovation,"[13] Secretary Steven Mnuchin noted, "America is a leader in

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[12] U.S. Federal Reserve, Report on the Economic Well-Being of U.S. Households in 2017 (May 2017), https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf

[13] U.S. Department Of Treasury, A Financial System That Creates Economic Opportunities Nonbank Financials, Fintech, and Innovation, (July 31, 2018), https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation_0.pdf

innovation. We must keep pace with industry changes and encourage financial ingenuity to foster the nation's vibrant financial services and technology sectors." [14] I couldn't agree more with the Secretary's statement, and I believe policymakers on both sides of the aisle should use his words to guide further engagement.

It is important for the United States to be a leader in Fintech. And policymakers must work together, put politics aside, and maintain support for the industry. The industry should continue to be regulated in a manner in which spurring innovation is the guiding principle, and consumer protection remains the top priority.

Bank-Fintech Partnerships Are Essential To Helping American Consumers

The boom in technology that is unique to the Fintech industry has not happened by accident. Partnerships between banks and Fintech have been essential in realizing the promise of Fintech in the delivery of better financial products to consumers. These partnerships have created an environment where all industry participants and more importantly, consumers, win.

This collaborative process between banks and Fintech has been necessary because banks have largely exited the business of providing loans to non-prime borrowers. Financial institutions have reduced available credit offerings by $142 billion since 2008. At the same time, 40 percent of Americans cannot afford to cover $400 in unexpected expenses such as car or home repairs, emergency travel, sudden health issues, or back to school essentials for kids. This situation is unsustainable for market participants and the economy generally. Credit-constrained consumers are left with few options to cover unexpected expenses and banks feel powerless to help serve them.

These partnerships between banks and Fintech companies are already a proven solution to this problem. Banks already have the relevant customer information through their relationship with depositors, and they have a low cost of capital. Fintech companies like Elevate have advanced analytics, machine-learning, and over 10,000 variables that produce a greatly enhanced and comprehensive consumer credit profile. [15] Ultimately, through a partnership, companies like Elevate are able to provide consumers with the product they need, when they need it, in a regulated environment.

And it's a win-win-win as these partnerships with Fintech companies can be the lifeline and the competitive edge that small banks need to ensure sustainability in a rapidly evolving time for the industry.

[14] U.S. Department Of Treasury, Treasury Releases Report on Nonbank Financials, Fintech, and Innovation, (July 31, 2018), https://home.treasury.gov/news/press-releases/sm447

[15] Ken Rees, Expanding Opportunities for the New Middle Class, (March 21, 2018), https://about.bgov.com/blog/bloomberg-next-tech/

Congress has an opportunity to ensure consumers continue to benefit from these partnerships. Two pieces of bipartisan legislation are currently under consideration in both the House and the Senate, and would foster the continued innovation needed to cultivate expanded consumer choice and access to safe and affordable credit.

Federal lawmakers can act now. This Committee should pass the "Modernizing Credit Opportunities Act" which would clarify that traditional lending institutions are the "true lender" in contracts between banks and Fintech companies. The Senate can act too by passing "Protecting Consumers' Access to Credit Act," which previously passed the House in a large bipartisan majority. This bill codifies that loans are "valid-when-made," meaning if a loan is valid when it is originated it cannot be invalidated when it is sold to another person or entity. Combined, these legislative solutions will ensure our customers continue to have access to the products they deserve and will enable banks to re-enter small-dollar lending business. It is clear that if innovation, inclusion, and accessibility are your goals, bank-Fintech partnerships are the answer.

Representative Meeks, a cosponsor of the bill which codifies the "valid-when-made" principle, recently called upon Congress to come to the table and work with stakeholders to get legislation right. He said that industry, consumer groups, and Congress should come together in a non-adversarial environment to write legislation that works for the industry and provides consumer protections. Clearly, members of this Committee think that these bills are part of the answer.[16]

Fintech and Financial Services Companies Must Develop a Diverse Workforce to Reflect the Communities and Customers They Serve

I've worked at different companies within the financial services industry, from a community bank serving primarily African American customers, to Elevate which primarily serves non-prime consumers. I've seen companies with an alarming lack of diversity. And these companies lose out, because it is clear that diversity helps companies develop a deeper understanding of their customers. Elevate's success at developing unique and innovative products has been due to our commitment to diversity in our workforce. Simply put, diversity helps everyone succeed. We surface more innovation, create more change for an overall customer base, and provide products that are truly inclusive because we encourage and engage in open communication amongst individuals from different ethnic backgrounds, socioeconomic histories, professional and educational experience, and geographic origins.

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[16] Rep. Gregory Meeks, A Moderated Discussion With Representatives, Bloomberg Government (September 2018), https://about.bgov.com/event/fintech2018/

There are serious ramifications when companies don't have a diverse workforce and don't understand or align with the communities and customers they serve. This can lead to issues around under-banking, or banking deserts, which have stark consequences for lower-income Americans. A 2017 BCFP report shows that lower-income Americans are more likely to become credit visible due to negative financial experiences rather than positive ones. We need to be doing more to lift these Americans up, not push them down.[17]

Legislation like the "Credit Access and Inclusion Act," which passed the House earlier this year and is being considered in the Senate would help alleviate this problem. This legislation will enable a more comprehensive view of non-prime American's credit worthiness by allowing reporting agencies to collect positive financial information from housing agencies and utility companies, enhancing hard-working Americans' credit scores.

Representative Cleaver's report also states, "Congress must ensure that those who are already at a historic or economic disadvantage aren't being unfairly targeted by the proliferating financial sector."[18] Congress must act quickly, and as an industry, we must work hard to hold each other accountable and to an even higher standard. While we use alternative data sources to reach new customers and evaluate the risk drivers of affordability, delinquency, and charge-offs, vigilance remains necessary. And we must all be on the watch for bad actors who intend to create predatory products targeted at not just non-prime, but any group of consumers.

I am proud to work at a company that prioritizes serving the underserved and under-banked and is truly invested in our customer's financial well-being. Fintech companies must be fair, accountable, honest, and transparent. Real change is possible, but it will require more than just talk.

I applaud members of this subcommittee, particularly Chairman Luetkemeyer and Ranking Member Clay for convening this hearing, and I thank all committee members for the opportunity to discuss the role Fintech plays in our economy and for studying the subject so diligently. With the right regulatory approach and action from policymakers, I am confident we can build an environment in the United States that supports customer-focused innovation.

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[17] CFPB, CFPB Data Point: Becoming Credit Visible (June 2017) https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/BecomingCreditVisible_Data_Point_Final.pdf

[18] Rep. Emanuel Cleaver, Fin Tech Investigative Report (August 17, 2018), https://cleaver.house.gov/sites/cleaver.house.gov/files/Fintech_Report_1.pdf

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September 28, 2018

Chairman Luetkemeyer, Ranking Member Clay and members of the subcommittee my name is Michael Price and I am President and CEO of First Commonwealth Bank. We are a $7.6 billion community bank based in Indiana Pennsylvania. We employ over 1,400 people across Pennsylvania and Ohio, and as the Number 2 SBA lender in our markets, we extend nearly $500 million in small business loans to our communities. Thank you for the opportunity to be here today to testify on behalf of the Pennsylvania Bankers Association to discuss opportunities for financial markets in the digital era.

New technologies are quickly changing the ways all businesses connect with their customers. "Fintech" is a term used to capture this convergence of banking and technology. While it has been used to refer to tech-focused startups, innovative technologies are offered by banks and startups alike. While many of these technologies may feel new, they typically leverage new technology as a delivery channel for traditional banking products and services.

Innovation in financial services has the ability to benefit consumers across the country and drive growth in our economy. New technologies allow financial service firms to connect with customers in new ways and offer them products that may better fit their needs. It can lower costs, making financial services more affordable for consumers across the country. It provides added convenience and efficiency, giving customers the ability to manage their finances day or night from the palm of their hand. Technology can also lower the fixed costs for providing credit to small businesses, leading to greater capital access that spurs economic growth.

Banks have always embraced innovation and continue to do so in order to better serve their consumers. Make no mistake, banks are pro-innovation, pro-consumer, and are very technology focused. Banks have pioneered important innovations in banking, such as ATMs, credit cards, online banking, and remote check deposit. Banks continue this innovation today, investing billions of dollars annually into technology to bring their customers the latest apps delivered through secure and trusted channels.

However, it is important to note that technology is not a replacement for a community presence. Community banking has always been a relationship business. While banks are driving technological innovation, we remain a visible presence, supporting our local communities as we always have through community outreach and countless hours of volunteering – something that cannot happen through a key stroke or algorithm.

Innovation only enables these benefits if it is delivered responsibly. Customers deserve consistent protections where ever they receive financial services. A loan is a loan no matter who provides it. Companies that want to engage in the business of banking must be willing to be regulated and supervised accordingly.

In my testimony today I will stress the following three points:

- Banks are innovating and partnering;
- Community banks are critically important; and
- Consumers deserve consistent treatment.

Banks are Innovating and Partnering

Today, banks of all sizes are innovating and partnering with technology-powered startups to deliver innovative products and services to their customers. Banks are investing significant resources into developing new technologies. While some have gone as far as establishing "innovation labs," banks of all kinds are delivering innovative products to their customers. All banks invest significantly in technology and today, much of this investment is devoted to new financial tools and apps. Banks innovate within a strict regulatory environment. Security and privacy of customer information is always the top concern for banks. When banks innovate and partner with startups, customers get innovative services from a trusted channel.

Partnerships to Move Forward

In addition to developing their own new products and apps, banks are actively partnering with fintech startups to deliver innovative products and services to their customers.

Startups and banks both bring a lot to the table and each have a unique set of strengths that are often complementary. Startups' freedom from legacy systems and lighter oversight makes them nimble and gives them the ability to bring new products to market and test them quickly. This has allowed them to build innovative and intuitive user experiences.

Banks are key drivers of innovation as well, delivering new products to market through both internal development and partnerships. Banks have strong customer relationships built on a foundation of trust earned through years of doing right by customers. This trust is backed by a strong culture of compliance and a regulatory framework designed to protect customers.

This trust, which is foundational to banking, is not easily replicable by startups. Establishing and growing customer relationships is the largest challenge for startups. Banks bring tremendous value to the table in their role as trusted custodians of their customers' money and information. Moreover, banks have stable deposit funding which gives them the resiliency to offer innovative products throughout shocks and credit cycles.

Through collaboration and partnerships, banks and fintech companies can deliver the best technology-forward products to customers. At First Commonwealth, our technology partnerships have enabled us to deliver online account opening for loans and deposits, a state-of-the-art online personal financial management solution, mobile wallets, mobile banking and mobile deposit services, and person-to-person payments. Our digital roadmap includes dozens of new products and enhancements in the coming months and years that will promote ease of use, improve customer service, enable financial fitness and empower customers to manage their security and move money in real time.

New Interface, Traditional Products

At their core, most innovations in financial services closely resemble traditional banking products and services. The innovations being implemented today leverage new, digital delivery channels to give customers faster, more convenient access to traditional financial products. Online lending, for example, is just a new delivery channel for a product that has existed for many years – consumer and small business loans. Banks have always provided the consumer loans that help families reach their financial goals and the small business loans that drive local growth and job creation.

Digital nonbank lenders provide online interfaces that allow customers to apply for and receive credit quickly and easily. They fund these loans in a number of ways. Although many lenders act as a marketplace, matching borrowers with investors, many others originate loans that they hold to maturity. A number of banks also offer online application and approval for loans.

Online non-bank lenders typically target traditional borrowers and originate loans that closely resemble traditional loans. They are typically fixed rate, term based (with maturities ranging from 36-60 months), and are fully amortizing (with the loan paid-off at the end of its set term).

Community Banks Are Critically Important

First Commonwealth, like other community banks are the backbone of hometowns across America. Our presence in small towns and large cities everywhere means we have a personal stake in the economic growth, health, and vitality of nearly every community. A bank's presence is a symbol of hope and a vote of confidence in a town's future. When a bank sets down roots, communities thrive.

Relationship Banking Not Going Anywhere

While digital channels can add significant value for many customers, they are not for everyone. The high-touch relationship banking that banks, particularly community banks, offer are critical to communities across the country and is not fully replicable by technology.

A personalized approach allows banks to truly understand their customers and work with them, tailoring products to meet their specific needs. In his remarks on responsible innovation, former Comptroller Curry noted concerns about customers relying solely on online lenders. "I would worry about the staying power of some of the new types of lenders. One of the great virtues of community banks is that they know their customers and they stand behind them in good times and bad. I'm not so sure that customers selected by an algorithm would fare as well in a downturn."

There are a number of communities with limited access to the technology needed to take advantage of online financial services. The Pew Research Center estimates that 77 percent of American adults have access to smartphones in 2018 with 89 percent having access to the internet. These statistics show significant progress, but we cannot forget about the 23 percent of Americans without smartphones and the 11 percent without internet access. These statistics become much more pronounced when looking at low income and rural communities. Community banks stand ready to serve these communities as we always have.

Critical to the Economy

The credit cycle that banks facilitate is simple: customer deposits provide funding to make loans. These loans allow customers of all kinds—businesses, individuals, governments and non-profits—to invest in their hometown and across the globe. The profits generated by this investment flow back into banks as deposits and the cycle repeats—creating jobs, wealth for individuals and capital to expand businesses.

As those businesses grow, they, their employees and their customers come to banks for a variety of other key financial services such as cash management, liquidity, wealth management, trust and custodial services. For individuals, bank loans and services can significantly increase their purchasing power and improve their quality of life, helping them attain their goals and realize their dreams.

Each and every bank in this country helps fuel our economy. Each has a direct impact on job creation, economic growth, and prosperity. While large, regional, and midsize banks all have important roles, community banks are essential to prosperity in the areas we serve. While we make nearly a quarter of all bank loans, we account for nearly half of bank small business and commercial real estate loans—and more than two-thirds of agricultural loans from all banks.

Community Leaders

In addition to our on-the-ground ability to meet customers' financial needs creatively, community bankers are local leaders. We are involved in many community-serving organizations, serve on school and hospital boards, donate thousands of volunteer hours to charities—all in addition to the advice we provide to business owners, families and individuals, young and old, about their daily financial needs.

At First Commonwealth our mission is to improve the financial lives of our neighbors and their businesses. It is our vision to support our communities as active leaders and a good corporate citizen. Our bank contributes well in excess of $1 million annually to charities and community organizations like the United Way, the American Heart Association, Habitat for Humanity, Boys and Girls Clubs of America, and community reinvestment groups. We support and encourage our employees to be active and committed citizens of their communities by serving on the boards of local hospitals, YMCAs, food banks, and chambers of commerce and volunteering their time and energy as laborers, counselors, teachers and coaches. In short, we are a visible and vital part of every city and town in which we do business.

Consumers Deserve Consistent Treatment

Innovation in financial services promises to bring great benefits to customers across the country. These benefits are only realized when innovative financial products are delivered responsibly in a way that does right by customers. This means getting regulation right is critical.

Banks have served as a trusted provider of financial services for centuries and take that role very seriously. This trust is supported by strong regulation and proactive oversight that ensures that issues are addressed before any harm is done. Comparatively, most fintech startups are subject to supervision by the FTC, which primarily regulates via enforcement, only levying fines once harm has already occurred.

Regulation must be flexible enough to allow innovations to be driven from within traditional banks. We must also ensure that customers receive the protection they deserve wherever they get their financial services through consistent regulation and oversight. Customers deserve consistent treatment wherever they go for their financial services.

Regulation Should Be Based on Activities

The nature of the activities that a company facilitates, not the company structure, is what matters. Good regulation helps identify and control for risks. Many innovations, at their core, are traditional banking products offered in new ways. By focusing on the activity taking place, regulators are best able to assess the risks being presented to consumers and the system.

Effective oversight can help financial providers identify compliance gaps before there is consumer harm. More importantly, oversight is needed to ensure that malicious actors do not take advantage of customers.

Safeguarding Customer Data

Technology has facilitated the creation of an unprecedented amount of consumer financial data. As the amount of data has grown, so has the number of companies interested in leveraging it. Consumer financial data are extremely sensitive and must be protected appropriately. Accordingly, Congress has recognized the sensitivity of financial information and has provided protections for it in the Gramm-Leach Bliley Act of 1999 (GLBA)–obligations that apply to all parties that hold it throughout its lifecycle.

Banks take very seriously their responsibilities to their customers to maintain the highest level of privacy, security, and control over their financial assets and transactions, which is why the issue of data sharing – and getting it right – is so important to our industry. Today, consumers trust that their financial data are being protected and handled appropriately. Current practices in the data aggregation market, however, may leave consumers exposed and create risks that undermine this trust. This trust is critical to the functioning of the financial system and is the reason banks dedicate tremendous resources to safeguarding financial data.

To Consumers, a Loan is a Loan

To consumers, a loan is a loan. When making financial decisions, consumers expect the same level of protection regardless of the provider. Federal law provides for numerous protections for consumers when they borrow, and they expect this same level of protection in all financial services interactions.

Banks operate in a heavily regulated environment that ensures all new products are safe before they get into a customer's hands. Banks have robust risk controls around these products that ensure customers are protected. This culture of compliance leads to better outcomes for consumers which builds trust.

The rules governing lending generally apply to banks and nonbanks alike. Consumer protection laws apply regardless of provider. Moreover, all small business loans are subject to a number of rules to ensure customers are treated fairly.

Despite these protections, customers report a very different experience when they go to a bank versus a non-bank lender. The 2017 Small Business Credit Survey revealed far-lower satisfaction rates for online lenders than those of traditional banks – even when approved. More than half of online lender applicants expressed dissatisfaction with high interest rates, and one-third cited unfavorable repayment terms.

When asked who they would turn to for funding, small businesses overwhelmingly prefer traditional financial institutions to online lenders. As one respondent put it, "I would most likely try a traditional bank first. I'm looking for credibility and reliance. Then I'd look online just to see my options."

The key differences leading to positive customer outcomes at banks are: (1) a long history of serving customers and the community; (2) a culture of regulatory compliance with regulations; and (3) effective oversight—including stringent and regular examination—by state and federal agencies proactively addressing concerns before customers are impacted negatively. Oversight would ensure more transparency in non-bank online lending that would lead to better outcomes for customers.

Today, there are a number of non-bank online lenders adhering to sound lending practices and serving their customers well. Constructive oversight will help them provide better service to their customers. Oversight also will identify and capture bad actors.

When banks partner with online lenders they ensure compliance with the many rules and regulations. Banks are required to fully vet all of their non-bank partners through third party vendor management guidelines. This relationship means that products offered in coordination with banks are often subject to greater oversight.

Conclusion

Once again, thank you for the opportunity to offer my perspective on behalf of the Pennsylvania Bankers Association and for your attention to the importance of responsible innovation in financial services. Banks fully embrace the tremendous potential of innovation in financial services to benefit consumers and businesses across the country. We are making significant technology investments, building internally, and partnering with innovative fintech startups.

As policy makers look to encourage innovation, we must not lose sight of the tremendous value community banks offer to their local communities. Technology cannot wholly replace a local presence and we must make sure that the benefits of innovation are delivered responsibly so that customers receive consistent treatment regardless of their provider.

Testimony of

Stuart Rubinstein

President, Fidelity Wealth Technologies & Head of Data Aggregation

Before the

House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing entitled
"Examining Opportunities for Financial Markets in the Digital Era"

September 28, 2018

Chairman Luetkemeyer, Ranking Member Clay, and Members of the Subcommittee: thank you for holding this important hearing. Fidelity is very interested in fintech and data policy and has a unique perspective to share.

My name is Stuart Rubinstein and I am President of Fidelity Wealth Technologies and Head of Data Aggregation. In this role, I oversee the team focused on helping Fidelity and other institutions enable consumers to securely share account data and documents with third parties. Fidelity is a leading provider of investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing, and other financial products and services to more than 30 million individuals, institutions, and financial intermediaries with more than $7 trillion in assets under administration. Our goal is to make financial expertise broadly accessible and effective in helping people live the lives they want.

I will focus my testimony for this hearing on an issue I first worked on over 20 years ago: financial data aggregation services and ways we can make data sharing safer and more secure.

Fidelity's Perspective on Data Aggregation

Fidelity has a unique perspective on financial data aggregation practices and necessary protections for customers. We are on all sides of this issue: we are an aggregator of data for third parties,[1] we are a significant source of data for aggregators acting on behalf of our mutual customers, and we offer a data aggregation service for our retail customers and retirement plan participants.[2] This perspective gives us a thorough understanding of the benefits of financial data aggregation, but also of the very real cybersecurity and privacy risks that current data aggregation industry practices create.

Financial data aggregation in this context refers to services that, with customers' consent, collect financial information from their various bank, brokerage, and retirement accounts, along with other sources, to be displayed and processed in an aggregated view. An example of this kind of service might be a budgeting and planning smartphone app. Consumers use third party applications that leverage data aggregation because they value tools to help manage financial planning, budgeting, tax preparation, and other services. As part of our focus on helping our customers, Fidelity works to make it possible for customers to access the services they want to use—including third party aggregation-based services. To that end, customers have been able to use their Fidelity data in third party applications for many years. However, the cybersecurity environment has significantly changed over that time and we have a responsibility to protect the very sensitive personal financial data and assets of our more than 30 million customers from misuse, theft, and fraud.

[1] Financial advisors can use *eMoney Advisor*, a Fidelity-owned business that provides account aggregation services along with software that helps them provide financial advice to their clients.

[2] Fidelity offers its *FullView®* services to retail customers through Fidelity.com and to retirement plan participants through NetBenefits.com, and developed its first account aggregation service over fifteen years ago. Fidelity *FullView* provides a snapshot of customers' net worth in a simple format with an ability to do budgeting and financial planning.

Current data aggregation practices make this challenging, because they rely on consumers providing their financial institution log-in credentials (i.e., username and password) to third parties. Those third parties, typically data aggregators, then almost always employ a practice known as "screen scraping." At its most basic, screen scraping involves the use of computerized "bots" to log-in to financial institution websites, mobile apps, or other applications as if they were the consumer. Once the bots have access to the site or app, they "scrape" customer data from the various screens to be presented on a consolidated basis, along with information scraped and collected from other sources.

There are two consumer data security problems with this practice. First, as a matter of basic security consumers should not be asked or required to share their private log-in credentials in order to access a third party service. Doing so creates cybersecurity, identity theft, and data security risks for the consumer and financial institutions. Unfortunately, we know that due to years of this practice, financial institution log-in credentials are now held by a myriad of companies. Some are likely very secure, while others may not be secure at all. Given this, allowing third parties to log-in using these credentials as if they are the customer creates significant risk of cyber-fraud. Because consumers go directly to data aggregators or their commercial clients and not their financial institution, the financial institutions never really know if the activity has in fact been authorized by the customers or if the customer credential has been compromised and a criminal is using the data aggregation service to test the credential's validity and illicitly gather data.

Second, screen scraping may result in access to data fields far beyond the scope of the service a third party offers the consumer—including personally identifiable information (PII) about consumers and in some cases their dependents. This means third parties have access to fields of information often used by financial institution call centers to identify customers. For example, if a consumer provides his or her log-in credentials to a budgeting app, that app potentially has access to sensitive personal information like customer dates of birth and dependent names and dates of birth, all of which might be data financial institutions use to verify customer identities online or over the phone. Collection of information beyond what is needed for the service the consumer has elected creates unnecessary risk. And all of this adds up to an array of risks financial institutions must navigate to protect the integrity of their systems and the assets of their customers.

In considering the challenges described above, Fidelity developed the following five principles that we believe should guide industry in creating better data sharing solutions:

1. **We strongly support consumers' right to access their own financial data and provide that data to third parties**. As a provider of aggregation services ourselves, we know that customers value these products, and the demand for aggregation is likely to increase. We also believe that the concept of access is broad enough to encompass security, transparency, and cybersecurity protections for consumers.

2. **Data access and sharing <u>must</u> be done in a safe, secure, and transparent manner.** We firmly believe credential sharing makes the system less safe for consumers, aggregators, and financial institutions alike. While we strongly support customer access,

the security of customer data, customer assets, and financial institution systems must be our primary concern.

3. **Consumers should provide affirmative consent and instruction to financial institutions to share their data with third parties.** Rather than trust that third parties who use customer log-in credentials to access a financial institution's website are authorized, customers should tell financial institutions which third parties have permission to access their financial data. This eliminates the potential that unauthorized access using credentials is mistaken for authorized access.

4. **Third parties should access the minimum amount of financial data they need to provide the service for which the customer provided access.** There should be a tight nexus between the service provided and the information collected by third party aggregators. For example, if a customer signs up for a tax planning service that leverages aggregation, that service should only access the information needed for tax planning.

5. **Consumers should be able to monitor who has access to their data, and access should be easily revocable by the consumer.** We believe data sharing and permissioning should be an iterative process, with customers engaged continuously. Moreover, many customers believe revoking access is as easy as deleting an app from their phone—this is not the case. Customers should be able to easily instruct their financial institution to revoke access when they no longer want or need the aggregation-based service.

We believe that embracing these principles will better protect consumers, aggregators, and financial institutions, and facilitate more efficient data sharing practices.

How Do We Solve This for Consumers?

Fortunately, although the risks and challenges of the current system are serious, there are steps financial institutions and aggregators can take together to improve the data sharing ecosystem. The financial services industry is employing technological solutions for the secure exchange and access of financial information. These technologies involve the implementation and use of application programming interfaces ("APIs"), which are provided by the financial institution to aggregators and other third parties. An API works in conjunction with an authentication process that is handled by the financial institution. There are authentication processes, for example "open authorization" ("OAuth"), that do not involve sharing of account access credentials with third parties. Consumers who want their data aggregated sign into their accounts at the financial institution's website and provide authorization for third party aggregators to access their financial data. The financial institution and the data aggregator then manage that connection through secure, encrypted tokens that are provisioned for the specific connection.

There are several compelling consumer and data security benefits for moving to APIs. First, it keeps log-in credentials private and secure by eliminating the need for consumers to share log-in credentials with third parties. This reduces the cyber, identity, and personal data security risks that exist when a consumer shares private log-in details with a third-party. Second, it puts the consumer in the driver's seat by giving consumers greater transparency and control of their data by allowing consumers to provide unequivocal consent and instruction to share their data with third parties. Third, it allows financial institutions and aggregators to agree on what data should be shared and avoid over-scraping. Fourth, it eliminates the need to reconfigure aggregators' systems every time a consumer changes his or her username or password or the financial institution updates its webpage. Fifth, it removes the traffic-intensive screen scraping activity from financial institutions' web sites and other digital properties, returning that capacity to the individual consumers for whom those sites were created. Finally, it enables the consumer to monitor the ongoing access and instruct their financial institution to revoke the consent if desired.

Fidelity Access

In November 2017, Fidelity announced its own API solution for data sharing called *Fidelity Access*℠. *Fidelity Access* will allow Fidelity customers to provide third parties access to customer data through a secure connection without providing log-in credentials. *Fidelity Access* will include a control center, where customers can grant, monitor, and revoke account access at any time. We have been working closely with aggregators and other third parties on adoption of this solution.

Of particular note, *eMoney Advisor*, Fidelity's affiliate that offers its own aggregation service, is committed to working with other financial institutions that offer APIs. By championing the exclusive use of APIs to facilitate customers providing third parties access to their financial data, we hope to show leadership by taking action to better secure our customers' data.

Industry Standards and Policymaker Guidance

In addition to our own efforts to address the problems with data aggregation, we have been working with a wide array of industry and public sector stakeholders. We support many of the data sharing and aggregation principles that have been put forth:

- In October 2017, after a year-long inquiry into the topic, the Bureau of Consumer Financial Protection (BCFP) released non-binding financial data sharing and aggregation principles, which helpfully emphasized the importance of access, security, transparency, and consent.[3]

- In February 2018, the Financial Services Information Sharing and Analysis Center (FS-ISAC), a cybersecurity information sharing group focused on the financial services industry, published a standard durable data API free of charge to help facilitate safer transfer of financial data.[4] The Fidelity Access API is based on this standard.

[3] *Available at* https://files.consumerfinance.gov/f/documents/cfpb_consumer-protection-principles_data-aggregation.pdf. Fidelity commented on the Request for Information that culminated in these principles (https://www.regulations.gov/document?D=CFPB-2016-0048-0053).
[4] *See* https://www.fsisac.com/article/fs-isac-enables-safer-financial-data-sharing-api. Fidelity is a member of FS-ISAC and contributed to the development of the durable data API.

- In March 2018, the Financial Industry Regulatory Authority (FINRA) published an investor alert that explained the risks associated with aggregation-based services and noted that many firms are moving toward APIs.[5]

- In April 2018, the Securities Industry and Financial Markets Association (SIFMA) released data aggregation principles that focused on similar themes.[6]

These efforts to provide guidance have brought many of the challenges and risks associated with data aggregation to the fore and encouraged healthy debate on how to solve them.

Continuing Challenges

Despite the general consensus that the status quo is untenable and the industry should move to safer data sharing technologies, there are roadblocks that prevent wider adoption of APIs and other solutions. Here are what we see as the most challenging:

- Inertia: One force working against adoption of safer data sharing technologies is simple inertia. Existing practices have been the norm for close to two decades. Getting firms to adopt new technologies can be challenging no matter what the benefits. However, given the stakes, with headlines replete with examples of cybersecurity events and data breaches, this is not an adequate reason to resist better data sharing technology.

- Cost: Another countervailing force is cost. One of the unfortunate truths about screen scraping is that it is cheap and effective. While safer technologies like APIs have become less costly as technology advances, building one does incur costs. We believe the incremental increase in cost is well worth the substantial security and transparency improvements for consumers. Still, financial institutions should be sensitive to this reality, which is why we are providing *Fidelity Access* to third parties free of charge.

- Liability: Liability is the most stubborn blocker to wider adoption of safer data sharing technologies. Third party aggregators want to limit their potential liability in the event that financial data is illicitly obtained. We have seen firms try to limit their liability to low dollar amounts. These kinds of limits are untenable for financial firms like Fidelity that have a duty to protect client assets. Fidelity believes firms that obtain and handle consumer data should be held responsible to protect that data from unauthorized use, just as we are. Any other standard creates moral hazard and does not incentivize aggregators to take their data stewardship responsibilities seriously.

Until all industry participants—aggregators, fintech firms, and financial institutions—are prepared to overcome these challenges in a responsible manner, we will not move as swiftly as we otherwise could to adopt safer data sharing technologies.

[5] *Available at* http://www.finra.org/investors/alerts/know-you-share-be-mindful-data-aggregation-risks.
[6] *Available at* https://www.sifma.org/resources/general/data-aggregation-principles/. Fidelity is a member of SIFMA and worked closely with other member firms in developing these principles.

Treasury Report on "Nonbank Financials, Fintech, and Innovation"[7]

In July 2018, the U.S. Department of Treasury issued a report entitled "A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation" (hereinafter "Treasury report"), in which it discussed at length the public policy challenges facing the data aggregation industry. We agree with much of the Department's analysis, including its focus on security, consumer consent and monitoring, revocability of consent, and liability. In particular, we would like to share views on the following data aggregation recommendations in the report:

- Third Party Access to Consumer Information: The Treasury report recommends that the BCFP affirm that properly authorized third parties are included within the definition of "consumer" for purposes of Sec. 1033 of the Dodd-Frank Act. Sec. 1033 gives consumers the right to access financial information from a BCFP-regulated entity.

  Fidelity View: To the extent this recommendation means consumers should be able to provide third party aggregators and fintech firms access to consumer financial information, we agree. However, financial institutions must have the ability to insist on providing data in a secure way, to protect the authorizing consumer and other customers. Providing third parties with consumer permissioned access must not be conflated with allowing a third party to impersonate a consumer by using their credentials.

- Entities Covered by Data Access Requirements: Sec. 1033 applies only to financial institutions regulated by the BCFP, which includes banks and other providers of consumer financial products. The report recommends not expanding the scope of Sec. 1033 to other institutions.

  Fidelity View: We agree. The barriers to establishing safer data sharing technologies are not a result of a regulatory gap. We believe functional financial regulators (SEC, FINRA, DOL, etc.) should examine ways to study secure data sharing for firms under their jurisdiction, and many are beginning to weigh in.

- Disclosure and Consent: The Treasury report recommends the BCFP work with the private sector on creating best practices with respect to providing clear, conspicuous, and understandable disclosures to consumers providing access to their financial data to third parties.

  Fidelity View: We agree that providing consumers with clear, conspicuous, and understandable disclosures that show to whom they are providing access and what that third party is doing with their financial data is critical. We also agree that regulators helping the private sector develop best practices, rather than mandated disclosures, is the better approach.

- Revocation: The Treasury report also recommends consumers be empowered to terminate third party access to the consumers' financial information at any time. The report goes on

[7] *See* https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation_0.pdf.

to endorse, if necessary, additional regulations to empower financial institutions to revoke third party access at the request of consumers.

Fidelity View: We agree that consumers must be able to easily revoke third party access to their financial data. Further, we believe that consumers directly instructing financial institutions to share their data will allow those financial institutions to assist consumers by both monitoring that ongoing sharing and revoking the authorization at their request.

- Private Sector Solutions: Finally, the Treasury report recommends the private sector develop a solution to existing problems with data sharing that moves away from dangerous practices like screen scraping and embraces safer sharing methods like APIs. The report also recommends that this private sector solution should address the problem of liability for unauthorized access, theft, or misuse of consumer financial data.

  Fidelity View: We agree that a lasting solution to this problem must come from a cooperative effort by the financial institutions, aggregators, and fintech firms that participate in the data sharing ecosystem. We believe policymakers have a role in guiding the private sector in the right direction by discouraging the practice of credential sharing and clarifying that financial institutions, aggregators, and fintech firms are all responsible for protecting customer financial data that they hold.

Data Breach Notification

In order to reduce the complexity of complying with 50 unique state data breach notification laws, the Treasury Report recommends that Congress enact a federal data breach notification law that would preempt state data breach laws.

Fidelity View: To simplify the increasingly complex 50-state data breach notification regime, Fidelity would support a federal data breach standard that preempted state data breach notification laws and included robust consumer protections. As part of the legislative process, Congress and any relevant regulatory agency should ensure that companies have adequate time to investigate a potential breach and that consumers benefit from a required and timely notification related to a breach of their personal information.

* * *

Thank you again for the opportunity to testify and I look forward to answering your questions.

Credit Union National Association
CUNA

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99 M Street SE
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September 27, 2018

The Honorable Blaine Luetkemeyer
Chairman
Subcommittee on Financial Institutions
and Consumer Credit
Committee on Financial Services
House of Representatives
Washington, DC 20515

The Honorable William Lacy Clay
Ranking Member
Subcommittee on Financial Institutions
and Consumer Credit
Committee on Financial Services
House of Representatives
Washington, DC 20515

Dear Chairman Luetkemeyer and Ranking Member Clay:

On behalf of America's credit unions, I am writing to express credit unions views ahead of the hearing entitled "Examining Opportunities for Financial Markets in the Digital Era." The Credit Union National Association (CUNA) represents America's credit unions and their 110 million members.

Technology has enhanced financial institutions' ability to deliver financial services to consumers. For many years, credit unions have embraced and developed technology to deliver essential services to credit union members. One example of this technology is the shared branch network that enables credit union members to obtain banking services at thousands of credit union branches that are not owned and operated by the credit union at which they are a member. To provide this service, credit unions developed technology that allowed credit unions' computer systems to work together.

Credit unions also embrace technological innovation brought by businesses normally operating outside of the financial services arena. Consumers can benefit from fresh ideas and new ways to deliver financial services. Credit unions are partnering with financial technology (fintech) companies to ensure that they continue to offer essential financial services in the most efficient and modern way possible. When credit unions and other financial services organizations offer tools and resources they do so under the supervision of federal and state regulators and also are required to follow many different laws that ensure protection of consumers.

Although CUNA supports the innovations developed and brought into the marketplace by fintech, we remain concerned the regulatory environment might create an environment in which consumers do not receive the same protections from unregulated businesses that offer services traditionally offered by credit unions and banks. A regulatory scheme that ensures consumers receive the same protections and those offering these services are subject to similar regulations and supervision credit unions and banks is important to safeguard consumers and the banking system.

We look forward to the testimony from the various technology companies and hope it sheds light on their view as to whether a regulatory environment is necessary for fintech.

On behalf of America's credit unions and their 110 million members, we look forward to further discussing privacy issues with you and the members of this committee.

Sincerely,

Jim Nussle
President & CEO

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September 27, 2018

Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Re: Statement for the record for hearing on Examining Opportunities for Financial Markets in the Digital Era, Sept. 28, 2018

Dear Chairman Luetkemeyer, Ranking Member Clay, and Members of the Committee,

Thank you for the opportunity to submit a statement for the record for your hearing on Examining Opportunities for Financial Markets in the Digital Era. A wide range of areas may be encompassed within that topic. This letter, which is submitted on behalf of the National Consumer Law Center's low income clients, makes several overarching points and refers you to a number of our materials on "fintech" topics for more detail..

Financial products and services are developing and changing rapidly as a result of a number of factors, including the spread and capacities of mobile devices and the internet, the growth of computer power, the increasing use of big data, algorithms and machine learning, and an explosion of nonbank startups that are taking a new look at how to design and deliver financial products and services. Many of these developments have led to innovations that will benefit consumers through improved access, lower prices, increased transparency, and financial management.

At the same time, it is critical to keep in mind that consumer protection must remain paramount, and that many innovative approaches also yield problems. "Innovations" such as pick-a-payment mortgages and securitized no-doc loans not only ruined many families but devastated our economy. There is no free lunch, and many products that appear to be free or low cost are paid for in some fashion – whether through hidden fees or costs, or by selling the consumer's personal data. New products or services may result in new problems that are hard to anticipate today or to identify through slick presentations.

The following are key points that we urge the Committee to keep in mind as it digs more deeply into the myriad of complicated fintech topics.

1. **Consumer protection in the fintech area must remain a shared federal and state responsibility.**

Strong, uniform federal consumer protection standards are of course important. But federal laws do not cover every topic and do not address every problem. States are more nimble and are more likely to address problems early, before they are recognized as national problems. States are also the laboratory of democracy. For example, states adopted laws giving consumers a right to freeze their credit reports long before Congress did so this year.

Unfortunately, federal banking laws and regulations have often preempted state consumer protection laws and inhibited states' ability to protect people when federal laws do not. One important role that states can play is as "first responders," as detailed in our 2009 white paper, "Restore the States' Traditional Role as 'First Responder.'" Congress recognized the role that preemption played in the financial crisis by imposing limits on the ability of federal banking agencies to preempt consumer protection laws in the Dodd-Frank Act. Yet, ignoring Congress's desire to limit preemption, the Office of the Comptroller of the Currency (OCC) has now proposed to allow a wide range of companies that are not banks to claim the mantle of a "national bank" and to ignore state consumer protection laws.

We strongly oppose a new fintech "national bank" charter for nondepository institutions. The preemption of state consumer protection laws by federal banking laws and regulations has led to numerous severe problems, including the foreclosure crisis, credit card abuses, and banks' unfair and deceptive efforts to increase overdraft fees. Enabling a new class of companies to be considered "national banks" would allow these companies to ignore state interest rate caps, state consumer protection laws, and state oversight to the great detriment of consumers. Maintaining state consumer protection cops on the beat is critical, as federal agencies cannot vigilantly protect consumers in all fifty states, federal priorities wax and wane, and state agencies are closer to the people of their respective states, more nimble, and able to react quickly when local problems first arise. These issues are further discussed in our January 2017 comments on the OCC's white paper on exploring special purpose national bank charters.

2. **State interest rate limits are the single most important protection against predatory lending, and neither special purpose charters nor rent-a-bank partnerships should be used to evade those limits.**

For both short-term payday loans and longer-term payday and other installment loans, limits on interest rates and fees are the single most important way of protecting consumers. As described in our report Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default, limits on interest and fees align the interests of lenders and consumers, and give lenders the incentive to lend only to consumers who have the ability to repay their loans. Given the lack of interest rate limits at the federal level, state usury laws are the bulwark against predatory lending and must be preserved.

For over 200 years, since the beginning of our nation, states have had the power to set interest rate limits and to protect their citizens from high-cost lending. The evisceration of state limits on fees and interest is one of the core reasons we oppose bank charters for nondepository fintech companies. In addition to the comments notes above, our press release earlier this year describes why a new OCC fintech charter could open the floodgates to predatory lending.

For example, U.S. Bank has just announced a new small dollar loan that will cost 70% to 88% APR. If the company were not a bank, that rate would be illegal in many states. As detailed in our report on state installment loan laws, a $500, 6-month nonbank loan with 88% APR is illegal in more than two-thirds of the states. A fintech charter would allow other lenders to make loans at those rates or even higher.

We also oppose rent-a-bank arrangements that allow a nonbank lender to make loans that would otherwise be illegal under state law. We have described the problems of rent-a-bank arrangements in several materials joined by other organizations including:

- Our 2016 comments on the FDIC's proposed third party lending guidance, which could codify standards that may permit dangerous rent-a-bank arrangements.
- Our opposition letter to H.R. 3299 (McHenry) and S. 1642 (Warner), which would reverse the "Madden" decision
- Our opposition letter to H.R. 4439 (Hollingsworth), which would reverse courts' "true lender" decisions and instead permit sham rent-a-bank lender arrangements.

3. **The marketplace lending industry is addressing a gap in bank loans but poses some concerns.**

In recent years, a number of online fintechs lenders, often called "marketplace" lenders, have begun addressing a need for mid-size loans of the type that many banks do not offer. These loans tend to be fixed rate, fixed term installment loans, which can be safer and more understandable for consumers than endless open-end products like credit cards. Many marketplace loans carry low rates, below those charged by credit cards, and within state interest rate limits.

However, there are a number of potential issues with marketplace loans and other online loan products. While many of these products have APRs below36%, the loans tend to be quite large – often $10,000 to $40,000. For a small $500 loan, 36% is an appropriate rate, but that is a very high and often unaffordable rate for a large loan. A new report that we will release next month will show that among the 39 jurisdictions (38 states and DC) that impose limits on the interest rate and fees for a $10,000 loan, the median annual percentage (APR) cap is 25% and almost all are below 36%. Yet many marketplace lenders use rent-a-bank arrangements of questionable legality to evade these caps and make large, higher cost loans than they could legally make directly.

Our 2015 comments to the Treasury Department on online marketplace lending describe a number of other potential issues with marketplace loans. These issues include:

- Use of consumer data in ways potentially inconsistent with the protections of the Fair Credit Reporting Act, privacy rights, and fair lending laws.

- Skewed origination incentives that could lead to poor underwriting.
- The mandatory or default use of preauthorized electronic payments, which can weaken consumers' control over their bank accounts, cause bank account closures, and create incentives for weaker underwriting.
- Evasion of state laws, including usury caps, consumer protection laws, and licensing and oversight requirements.
- The use of lead generators, which could lead to the sale of sensitive financial information, fraud, and other problems prevalent in the online payday loan market.

In addition, lenders who offer to refinance federal student loans could lead borrowers to lose important protections for loan forgiveness or payment reduction in the event of a drop in income or disability. Private loans carry few if any such protections.

4. Faster payments can benefit consumers, but can also lead to faster fraud.

The payments industry is working on a number of fronts to make faster, near real-time payments more available and ubiquitous. Our current payment infrastructure is decades old. Modernized payment systems offer many potential benefits, including the ability for anyone to easily pay anyone else; just-in-time bill payment for families living paycheck to paycheck; immediate wage access; and easier bank account balancing that may help consumers avoid overdraft or nonsufficient funds fees.

But faster payments can also lead to faster fraud. More ubiquitous faster payments could make it easier for a senior to pay a telemarketing scammer quickly. Even more concerning, some faster payment systems currently on the market or under development will make it much more difficult to recover funds from criminals who defraud consumers.

Today, if a scammer posing as the IRS convinces a consumer to provide her bank account and routing number so the scammer can debit her account, she can later challenge that payment as unauthorized. The rule should be no different if the consumer pushes a button on her smart phone. Either way, the authorization to pay the criminal was obtained through fraud.
The payment industry must deny access to scammers and other criminals, and the consumer protection rules governing faster payment systems must provide incentives for the industry to do just that. That means that consumers must be protected from all types of fraud and that institutions that enable scammers to receive funds must bear responsibility.

Sophisticated banks and payment systems are likely to be far more effective than consumers in developing measures to prevent fraud in the first place, identify it rapidly, and shut it down. We should not rely on old-fashioned public service announcements and warnings to consumers as our primary protection against fraud in faster payments.

These issues are discussed in my op-ed in American Banker on Will Faster Electronic Payments Mean Faster Electronic Fraud?

5. **Big data, alternative data, computer algorithms and machine learning offer benefits but we must be attentive to potential issues including discrimination, harm to working families, errors and privacy.**

The rapid evolution of computing capacity and the explosion of new types of data available to financial providers is leading to many new ways of analyzing consumer's data. The use of new technologies may make the application and underwriting process faster, simpler, more accessible, and potentially more accurate.

But algorithms can also identify correlations that lead to inappropriate and illegal discrimination against communities of color and other disadvantaged populations. Careful vigilance is important to identify the patterns that algorithms are producing in order to prevent fair lending violations.

In addition, it is important to remember that some sources of data yield their own problems. Credit reports continue to harbor the results of decades of discrimination, as we described in our issue brief, Past Imperfect: How Credit Scores and Other Analytics "Bake In" and Perpetuate Past Discrimination. Use of alternative data to address the issue of credit invisibility also poses number of other issues, as we discussed in our issue brief Credit Invisibility and Alternative Data: The Devil is in the Details and our comments to the CFPB in response to its Request for Information on Alternative Data.

Similarly, efforts to use utility payments to expand access to financial services are well intended, but could result in harming millions of families who are at times late on their utility bills, such as in the winter or summer months when bills may spike. Today, most utility companies do not report delinquencies unless the bills are charged off, result in a disconnection, or reach 90 days. Monthly and more universal reporting of late utility payments could interfere with state programs to help seniors and others keep the heat on in the winter and could lower credit scores or put families on the map for predatory lenders. These issues are discussed in our issue brief Full Utility Credit Reporting: Risks to Low Income Consumers.

6. **Data aggregators and use of consumer's transaction data have many benefits but pose a number of issues.**

A number of fintech companies are harnessing consumers' transaction data from bank accounts and other accounts to provide a wide range of services. These companies typically rely on data aggregators to access consumers' accounts.

Transaction data can be used in a number of ways that may benefit consumers, including providing improved or lower cost access to credit for thin or no file consumers; helping with personal financial management; and avoiding fees such as late fees and overdraft fees.

While consumers initially must provide their permission for access to their transaction data, the use of data aggregators poses a number of potential issues.

Companies may gain access to far more data, for far longer, and may share it far wider, than is necessary to deliver the product or that consumers understand or expect. Privacy policies are opaque, consumers have little control, and privacy laws are too weak to protect consumers. Though companies focus on "consumer permission," that permission may be no more meaningful than the requirement to click "I agree" on a website.

There are a number of security issues. Some companies access data through secure APIs, but others use risky screen scraping and require consumers to turn over their bank account passwords. Even when data sharing is through a relatively secure channel, data breaches happen at even the most sophisticated companies. It is not at all clear if consumers' sensitive personal information is held in a secure fashion, and consumers have absolutely no way of understanding if a fintech company can be trusted with their data. Banks and fintechs may feud – with the consumer caught in the middle – if a data breach leads to unauthorized charges.

The use of that data may pose the same issues described above for other types of big data, including disparate impacts on protected groups and predatory lending.

The collection of transaction data for credit, insurance or employment purposes by third parties is covered by the Fair Credit Reporting Act. Some data aggregators do consider themselves to be consumer reporting agencies covered by the Act, but some may not. Even for those that do, it may not be clear how FCRA obligations must be carried out in this context, including important provisions such as reasonable measures to ensure accuracy, consumers' right to get a copy of their "reports," adverse action notices, and procedures to resolve "errors." If data is used for purposes other than credit, insurance or employment, the same concerns about accuracy, privacy and appropriate use remain, but there may be no protections in place.

7. **Mobile devices have many capabilities but many consumers have limited, uneven, or no internet access.**

Many fintech services rely on mobile devices or internet access. Yet even in this digital era, many consumers do not have full access to the internet and many do not have smartphones. According to the Pew Charitable Trusts, over half of households who make less than $30,000 a year, and even a third of those who make up to $50,000 a year, lack home broadband. Of adults who do not use broadband at home, only one in five owns a smartphone. Even those who rely on mobile devices for their internet access may live in rural areas where service is spotty or they may have prepaid plans with limited data and service gaps when funds run out.

Thus, it is critical to ensure that a focus on fintech products does not lead us to abandon those on the other side of the digital divide. Research by the CFPB has found that lack of internet access has a strong relationship to credit invisibility. Improving internet access is one part of the solution. Ensuring that fintech banks and other companies serve the entire communities they serve – not merely around their sole physical headquarters – is also essential, as discussed in our 2015 comments on updating the Community Reinvestment Act.

Moreover, a hand-held device may not be sufficient to inform the consumer of all aspects of a complicated financial transaction. Paper-based communications, statements and disclosures remain important for those who want them, especially for those with incomplete, spotty or intermittent access. These issues are discussed in our 2014 comments to the CFPB on mobile financial services.

8. **Consumers are not a sandbox toy: some fintech "sandbox" proposals eliminate consumer protections in the name of vague, untested promises of innovation.**

Efforts to encourage safe and affordable innovations in the financial area are certainly welcome. Older laws and regulations also may need to be updated to address new products – and new problems – not envisioned when those laws were written.

But regulations should be updated through a carefully considered public notice and comment process. Wholesale proposals to waive consumer protection requirements in the name of vague promises of innovation are dangerous. If real consumers are exposed to financial products or services, they need real protections. Fintechs should not be allowed to "play" in the real world without complying with real laws. Indeed, unusual, untested approaches are the ones that most need careful oversight.

Fintechs testing new products are pushing for protection against legal uncertainty. They may seek guarantees that they will not be subjected to enforcement actions for violating current law or committing unfair, deceptive or abusive practices.

But up-front guarantees and agreements not to bring an enforcement action are completely inappropriate. It is impossible for regulators to fully understand how a new product or service will work or the impacts it may have on consumers. Certainly, regulators should exercise discretion in their approach to innovative products and services, and enforcement actions are typically a last resort. But it is not the job of regulators to provide legal counsel to companies or to give them a stamp of approval that they are complying with the law.

If a regulation needs to be updated, regulators should do so in a transparent process that involves input from all stakeholders, and any changes should apply to all applicable companies and consumers in an even-handed fashion. Regulators should not be picking winners and losers and adopting special rules for individual companies.

The word "sandbox" has no precise meaning, and there are some efforts to promote innovation with careful oversight that do not impose significant risks on consumers. But any proposal that involves waiving consumer protection laws or hindering enforcement of those laws should be rejected. These concerns are spelled out in our 2018 letter regarding Arizona's HB 2434, which created a regulatory sandbox.

We also strongly oppose the Consumer Financial Protection Bureau's proposed pilot disclosure program. That proposal would allow a trade organization to ask the CFPB to waive or eliminate disclosure laws – based merely on cost savings, with no showing of an improvement for consumers – on behalf of an entire industry with no notice and comment and no adherence to the rules of the Administrative Procedures Act. The proposal is also far outside the CFPB's authority for pilot model disclosures as set forth in the Dodd-Frank Act, 12 U.S.C.A. § 5532(e).

* * *

Thank you for the opportunity to submit this statement for the record.

Yours very truly,

Lauren K. Saunders
Associate Director
National Consumer Law Center
On behalf of our low income clients