BANKING INNOVATION OR REGULATORY EVASION? EXPLORING TRENDS IN FINANCIAL INSTITUTION CHARTERS

VIRTUAL HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER PROTECTION
AND FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTEENTH CONGRESS

FIRST SESSION

APRIL 15, 2021

Printed for the use of the Committee on Financial Services

Serial No. 117–16

U.S. GOVERNMENT PUBLISHING OFFICE
44–664 PDF WASHINGTON : 2021

HOUSE COMMITTEE ON FINANCIAL SERVICES

MAXINE WATERS, California, *Chairwoman*

CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
ED PERLMUTTER, Colorado
JIM A. HIMES, Connecticut
BILL FOSTER, Illinois
JOYCE BEATTY, Ohio
JUAN VARGAS, California
JOSH GOTTHEIMER, New Jersey
VICENTE GONZALEZ, Texas
AL LAWSON, Florida
MICHAEL SAN NICOLAS, Guam
CINDY AXNE, Iowa
SEAN CASTEN, Illinois
AYANNA PRESSLEY, Massachusetts
RITCHIE TORRES, New York
STEPHEN F. LYNCH, Massachusetts
ALMA ADAMS, North Carolina
RASHIDA TLAIB, Michigan
MADELEINE DEAN, Pennsylvania
ALEXANDRIA OCASIO-CORTEZ, New York
JESÚS "CHUY" GARCIA, Illinois
SYLVIA GARCIA, Texas
NIKEMA WILLIAMS, Georgia
JAKE AUCHINCLOSS, Massachusetts

PATRICK McHENRY, North Carolina, *Ranking Member*
FRANK D. LUCAS, Oklahoma
BILL POSEY, Florida
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
STEVE STIVERS, Ohio
ANN WAGNER, Missouri
ANDY BARR, Kentucky
ROGER WILLIAMS, Texas
FRENCH HILL, Arkansas
TOM EMMER, Minnesota
LEE M. ZELDIN, New York
BARRY LOUDERMILK, Georgia
ALEXANDER X. MOONEY, West Virginia
WARREN DAVIDSON, Ohio
TED BUDD, North Carolina
DAVID KUSTOFF, Tennessee
TREY HOLLINGSWORTH, Indiana
ANTHONY GONZALEZ, Ohio
JOHN ROSE, Tennessee
BRYAN STEIL, Wisconsin
LANCE GOODEN, Texas
WILLIAM TIMMONS, South Carolina
VAN TAYLOR, Texas

CHARLA OUERTATANI, *Staff Director*

Subcommittee on Consumer Protection and Financial Institutions

ED PERLMUTTER, Colorado, *Chairman*

GREGORY W. MEEKS, New York
DAVID SCOTT, Georgia
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
AL GREEN, Texas
BILL FOSTER, Illinois
JUAN VARGAS, California
AL LAWSON, Florida
MICHAEL SAN NICOLAS, Guam
SEAN CASTEN, Illinois
AYANNA PRESSLEY, Massachusetts
RITCHIE TORRES, New York

BLAINE LUETKEMEYER, Missouri, *Ranking Member*
FRANK D. LUCAS, Oklahoma
BILL POSEY, Florida
ANDY BARR, Kentucky
ROGER WILLIAMS, Texas
BARRY LOUDERMILK, Georgia
TED BUDD, North Carolina
DAVID KUSTOFF, Tennessee, *Vice Ranking Member*
JOHN ROSE, Tennessee
WILLIAM TIMMONS, South Carolina

CONTENTS

BANKING INNOVATION OR REGULATORY EVASION? EXPLORING TRENDS IN FINANCIAL INSTITUTION CHARTERS

Thursday, April 15, 2021

U.S. House of Representatives,
Subcommittee on Consumer Protection
and Financial Institutions,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:06 a.m., via Webex, Hon. Ed Perlmutter [chairman of the subcommittee] presiding.

Members present: Representatives Perlmutter, Meeks, Scott, Velazquez, Sherman, Green, Foster, Vargas, Lawson, San Nicolas, Casten, Pressley, Torres; Luetkemeyer, Lucas, Posey, Barr, Williams of Texas, Loudermilk, Budd, Kustoff, Rose, and Timmons.

Ex officio present: Representatives Waters and McHenry.

Also present: Representative Garcia of Illinois

Chairman Perlmutter. Good morning, everyone. The Subcommittee on Consumer Protection and Financial Institutions will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Also, without objection, members of the full Financial Services Committee who are not members of this subcommittee are authorized to participate in today's hearing.

As a reminder, I ask all Members to keep themselves muted when they are not being recognized by the Chair, to minimize disturbances while Members are asking questions of our witnesses.

The staff has been instructed not to mute Members except where a Member is not being recognized by the Chair, and there is inadvertent background noise. Members are reminded that all House rules relating to order and decorum apply to this remote hearing. If Members wish to be recognized during the hearing, please identify yourself by name to facilitate recognition by the Chair.

Members are also reminded that they may participate in only one remote proceeding at a time. If you are participating today, please keep your camera on, and if you choose to attend a different remote proceeding, please turn your camera off.

We are in a very busy time, but we have a subject that I think is particularly important and really goes to the heart of our subcommittee's business.

Today's hearing is entitled, "Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters."

I now recognize myself for 4 minutes to give an opening statement.

In 1863, President Lincoln signed the National Currency Act into law, taking the first step in establishing the national banking system. One of the primary goals of the National Currency Act and the subsequent National Bank Act was the standardization of currency to protect consumers against uncertainty in the valuation of bank notes, rampant counterfeiting, and fraud. In his 1864 address to Congress, President Lincoln said the fact that the government and the people will derive great benefit from this change in the banking systems of the country can hardly be questioned. A national system will create a reliable and permanent influence in support of the national credit and protect people against losses in the use of paper money.

At the heart of our banking system, there is a promise of consumer protection and benefit to the people. President Lincoln knew our national banking system needed to be reliable, stable, honest, consistent across all States, and effective. Over the last 150 years, the banking system has changed a great deal, but its core mission to serve the people by taking deposits, offering credit, and facilitating and intermediating transactions, remains principally the same.

In recent years, a variety of non-bank and Fintech companies have sought to engage in the business of banking or in activities very similar to banking. Few of these companies have sought traditional banking charters either because they are wary of the additional regulation and supervision that comes with being a bank or because the structure of their business does not fit squarely within a traditional charter. Many of the unconventional charters do not come with the same level of regulation and supervision that traditional charters require.

Despite the innovations of the last 10 years, many of the questions we will be discussing today are not new. Industrial loan companies (ILCs) have been around since 1910, and the debate over the separation of banking and commerce predates even the National Currency Act. In recent years, the Office of the Comptroller of the Currency (OCC) has granted Fintech companies banking charters, but the debate about what constitutes the business of banking and what makes banks special is a much older conversation.

We do not want to slow innovation, but it is the Congress' duty to ensure that change comes at the benefit of, and not to the detriment of, the people. As the economy continues to reopen from the pandemic, it is important that our financial system remains stable and strong and that consumers are treated fairly and honestly. Most banks and credit unions have been a source of strength in the pandemic, in part because of the stringent capital, liquidity, and other regulatory requirements we place on these financial institutions.

I look forward to the discussion today. I want to compliment the panel on their very thorough written testimony, and I will be very interested to see how well all of you can stick to 5 minutes, based on your written materials. But we are going to be dealing with financial stability risks, consumer protection issues, market fairness questions, and the potential benefits of non-traditional banking charters.

Additionally, I would like to ask both the committee members and the witnesses today to consider how we can encourage innovation alongside strong consumer protections, adversity, and inclusion in our banking system. With that, I will yield back, and I would like to now recognize the ranking member of the subcommittee, Mr. Luetkemeyer, for 4 minutes for his opening statement.

Mr. LUETKEMEYER. Thank you, Mr. Chairman, for having this hearing on this important topic.

And thank you to our witnesses today. I look forward to your testimony.

As many of you know, before coming to Congress I was involved in the banking business both as a banker and as a regulator for many, many years. While it may surprise you to know I was not around during the Great Depression, I have seen a lot of changes within the banking industry during my 40 years as a regulator and a banker. And, Mr. Chairman, you don't need to be laughing at that. You are not much younger than I am.

I remember the Savings and Loan crisis of the 1980s. I remember when people thought the innovation of credit and debit cards would completely eliminate checks. I also remember when the Community Reinvestment Act (CRA) was signed into law, and, like everyone at this hearing, I remember the crash of 2008. Throughout the years, banking has been fluid. It has changed with the times, adapted to become more capitalized, and adapted to serve more Americans.

We are having this hearing today because the banking system is changing once again. In the last decade we have seen a rise in technology or Fintech companies that have truly pushed the innovation of the banking industry from mobile payments to algorithmic lending, and much more. As these entities have grown significantly in the last decade and become more permanent in our banking system, they have begun to seek out chartering options that are consistent with the growth of their companies. The OCC has been extremely active in this space and sought to provide a chartering option for Fintechs through a special purpose national bank charter for Fintechs. However, that decision has been tied up in the courts in recent years. The OCC has also discussed the idea of a national charter for payment companies and separately has approved anchorage for a national trust charter, making it the first digital asset bank.

We should examine the pros and cons of the OCC's actions, but we should also examine the role of State banking regulators and regulation charting of Fintechs. Is the current State regulatory regime adequate and is it necessary for the program to get involved?

Another pathway explored by numerous entities to enter the banking system is the industrial loan company (ILC) charter. While ILC's are regulated on a Federal level by the FDIC and supervised by State regulators, the parent company is not considered a bank holding company by the Bank Holding Company Act. This is a critical difference between bank holding companies that are supervised by the Federal Reserve and are restricted by law in activities closely related to banking. The separation of banking and commerce has been a key staple of our dual banking system, and the rise of the ILC approvals and applications does raise questions of banking and commerce separation safety and soundness, and privacy, questions which I look forward to asking today.

However, before Congress acts rashly to eliminate any chartering options, it is critical to look at the entire ecosystem of chartering in the banking industry. For example, since 2010, there have been only 43 de novo banks. In that same period of time, the number of FDIC-insured depositories has decreased by roughly 2,000 institutions; that is almost 4 banks per week.

In addition, the innovation of Fintech companies has largely increased access to credit and lowered the number of unbanked and underbanked people in our society. The current bank-Fintech partnership model has proven extremely successful not only in providing more services and access to businesses and consumers, but also significant consumer protections and oversight to the regulation and supervision of banks. Congress should examine all of these issues when taking action affecting the charters of institutions.

I have always said that if you want to be a bank, you need to be regulated like a bank. If you believe this can be accomplished while providing a regulatory and chartering framework that allows Fintech companies to continue to thrive in the banking industry, while protecting the status of banks as the bedrock of our financial system, so be it. I look forward to raising these questions today. And with that, Mr. Chairman, I yield back. Thank you so much for the hearing.

Chairman PERLMUTTER. I thank the gentleman.

The Chair now recognizes the Chair of the full Financial Services Committee, the gentlewoman from California, Chairwoman Waters, for the balance of our 5 minutes, which I think is about a minute and 23 seconds.

Chairwoman WATERS. Thank you very much, Chairman Perlmutter, for holding this very important hearing.

The pandemic has accelerated the way people use technology to bank, obtain a loan, and make payments. At the same time, State regulators, community banks, credit unions, and consumer advocates have raised alarms about how new entities, including Big Tech firms, are receiving unconventional charters and offering banking products and services while evading regulations with which most banks, including community banks, comply.

Additionally, the OCC has overstepped its authority, pretending that laws signed by Abraham Lincoln were intended to create charters for Fintech or cryptocurrency. I look forward to hearing from our panel on how Congress can promote responsible innovation that does not lead to a regulatory race to the bottom, where consumers get hurt and the safety and soundness of our financial system is once again in peril.

I yield back the balance of my time, and I thank you very much.

Chairman PERLMUTTER. Thank you. The gentlelady yields back.

Now, I would like to recognize the ranking member of the Full Committee, the gentleman from North Carolina, Mr. McHenry, for the balance of his 5 minutes.

Mr. MCHENRY. Thank you, Mr. Chairman.

And, Mr. Brooks, I want to personally thank you for your leadership at the OCC and for testifying today. I wish you the best in your future endeavors.

It is clear that my colleagues on the other side of the aisle want to relive old debates here in the committee, and this is certainly an old debate. In framing this discussion, I will have to go back to my talking points in my notes from 2005, 2006, and 2007. I have used this quote before, but to quote Talleyrand in speaking about the Bourbon dynasty, "They had learned nothing and forgotten nothing." It is all the same here, yet consumers and businesses have preferences and continue to evolve.

The private sector is innovating in new ways to meet the needs of all of our consumers, and we should be encouraging our regulators to seek regulatory requirements that fit these advancements, not hinder them. Republicans support promoting an up-to-date regulatory framework that sets clear rules of the road for all participants. We want, and will continue to work for, the most inclusive financial system possible. And I yield back.

Chairman PERLMUTTER. The gentleman yields back, and that is the first time I have heard about Talleyrand in 11 or 12 years, so thank you very much, Mr. McHenry.

I am now pleased to welcome each of our witnesses, and to introduce the panel. And I will let you all know that there are three Coloradans on this panel, which makes it a particularly outstanding group to testify before the committee.

First, we have Raul Carrillo, who is the deputy director of the LPE Project, and an associate research scholar at Yale Law School. Mr. Carrillo's work focuses on the legal foundations of money, banking, and finance as a legal technology and mode of governance. Prior to joining the LPE Project, Mr. Carrillo was policy counsel at the Demand Progress Education Fund and a fellow at the Americans for Financial Reform Education Fund.

Second, we have Erik Gerding, who is a law professor and a Wolf-Nichol Scholar at the University of Colorado Law School. Professor Gerding's research interests include banking law, the regulation of financial products and institutions, payment systems, and corporate governance. He has written extensively on the interaction between asset price bubbles and financial regulation. Professor Gerding previously taught at the University of New Mexico School of Law, and he has practiced law in New York and Washington.

Our third panelist is Kristin Johnson, who is the Asa Griggs Candler Professor of Law at Emory University School of Law. Ms. Johnson's recent work includes a focus on emerging technologies such as distributed digital ledger technologies, which have enabled the creation of digital assets and intermediaries. Prior to her work at Emory University School of Law, Ms. Johnson served as the McGlinchey Stafford Professor of Law and Associate Dean for Faculty Research at Tulane University Law School.

Our fourth panelist is Carlos Pacheco, who is the CEO of Premier Members Credit Union in Colorado, testifying on behalf of the National Association of Federally-Insured Credit Unions (NAFCU). Mr. Pacheco has been CEO of Premier Members Credit Union since 2011, and he also serves as the board director for the Denver Boulder Better Business Bureau, and the cabinet campaign chair for the Foothills United Way.

Finally, we have former Comptroller of the Currency Brian Brooks, a native Coloradan from Pueblo, Colorado. Mr. Brooks served as Acting Comptroller of the OCC from May 29, 2020, to January 14, 2021, after serving as Senior Deputy Comptroller and Chief Operating Officer at the OCC, where he oversaw bank supervision, systemic risk identification support, innovation, and other issues. Prior to his work at the OCC, Mr. Brooks served as chief legal officer of Coinbase Global, a cryptocurrency exchange.

Oh, and I should say to the two panelists not from Colorado, we would be happy and honored if you chose to come to Colorado.

Witnesses are reminded that your oral testimony will be limited to 5 minutes. You should be able to see a timer on your screen that will indicate how much time you have left and a chime will go off at the end of your time. I would ask you to be mindful of the timer and quickly wrap up your testimony if you hear the chime so we can be respectful of both the witnesses' and the committee members' time. And without objection, your written statements will be made a part of the record.

Once the witnesses finish their testimony, each Member will have 5 minutes to ask questions.

We will begin with Mr. Carrillo. You are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF RAUL CARRILLO, DEPUTY DIRECTOR, LPE PROJECT, AND ASSOCIATE RESEARCH SCHOLAR, YALE LAW SCHOOL

Mr. CARRILLO. Thank you, Chairman Perlmutter, for the invitation. And thank you to Chairwoman Waters, Ranking Member McHenry, Ranking Member Luetkemeyer, and all of the members of the subcommittee. I offer my testimony as an associate research scholar at Yale Law School, but most of my principles here were created or developed by me as an attorney fighting and building on behalf of low-income and no-income clients in New York City, along with a group called New Economy Project.

I echo my remarks to the Financial Technology Task Force last September and humbly request that everyone consider the deeper impacts of Fintech on democracy. There is now a need for serious stewardship. The pandemic response and the actions by regulators have cast into relief the fundamental ways in which governments shape money and markets. There is no taking politics out of tech because there is no taking the law out of tech or vice versa. Like physical tools, humans create and use legal tools with certain ideas for their use in mind.

This morning, I have the luxury of presenting alongside Professor Johnson, and Professor Gerding, and I will thus defer to them on many issues or otherwise point to my written testimony. I would like to focus on one underemphasized dimension of Fintech here today, and that is privacy and security. I hope to stress that the mass perpetual preemptive and predictive surveillance that is perpetuated by both the Government and private technology companies, often very much in partnership, including Fintech companies, should be of deep concern to everyone, regardless of party affiliation.

Civil rights and civil liberties including our fundamental freedoms under the Fourth Amendment, the First Amendment, and general law, warrants the parliament and the commoners won against the tyranny of King George. Certain invasive products and partnerships should not be allowed in our system regardless of whether they are considered to be arbitrage or not by regulators. Treating innovation as an unqualified good does not lead us to equitable, sustainable, cooperative innovation that allows us to truly prosper together.

As Vanderbilt Law Professor Morgan Ricks has stressed, and President Lincoln might agree, money is infrastructure. As scholars like Christine Dezan and Lev Menand stress, money is also part of our constitutional order, and regulation flows from Congress' authority over the public purse.

On the corporate side, surveillance has now become the business model of Fintechs and many other companies. Congress should shift the burden of privacy protection away from consumers by establishing a short list of permissible purposes for data collection and banning all others. This is envisioned by Senator Brown's Data Act of 2020. This is especially important because the government currently deputizes financial institutions as anti-money laundering (AML) cops on the beat.

In 1992, Congress required the filing of suspicious activity reports (SARs), relevant to any possible violation of the law. This has incentivized unburdened firms who must act as cops on the beat and send data, often automatically, to government "fusion centers." At these "fusion centers," which serve as data platforms for local and Federal law enforcement, Peter Thiel's Palantir aggregates information and shares it more widely with law enforcement around the world.

Unfortunately, there is a hole in Fourth Amendment doctrine. The court has claimed that we cannot have an expectation of privacy in anything shared with a business. This means, as the crypto community will tell you, that there is no privacy in finance. Our infrastructure has no place for privacy within it. This impinges not only on our Fourth Amendment rights, but on our First Amendment values of freedom of association and freedom of speech, especially for certain vulnerable communities.

In this context, it is deeply troubling to me that Fintech promotes financial inclusion via increasingly invasive biometric data. Moreover, an app or a bank account is not the answer to every problem. As Berkeley Law Professor Abbye Atkinson has recently stressed in concert with community advocates, credit is not a structural cure for poverty. It has downsides. People need better wages and better benefits.

Just as importantly, we should not consign everyday folks, including necessarily ourselves, to unnecessary and dangerous invasions of their privacy, our privacy, in order to participate in the payment system. We deserve to be one in the crowd. SARs have not made us safer. It is true that money laundering often occurs without notice. The most notorious example is HSBC's actions in laundering money for the Sinaloa cartel in Mexico.

Between 2010 and 2012, 18 financial institutions have received deferred prosecution agreements. At least four of them have broken the same AML law again and simply received another fine. BuzzFeed news and the International Consortium of Investigative Journalists recently released thousands of FinCEN files showing that the system does not work by its own logic, and again, does not make us safer.

I see the evolution of digital cash as a middle ground between privacy technology like crypto and folks who want the banking system to spy on all of us. I join Morgan Ricks, Lev Menand, John Crawford, Mehrsa Baradaran, Bob Hawkins, Holly Marova, and many others in advocating for public bank accounts at the Federal level. And I also join the activists fighting for this on the State and local level. Just as importantly, though, we need cash wallets that replicate the true privacy that a closed container for our cash has created.

The lead technologist on this and the best work is coming from Rohan Grey who is privacy lead at the International Telecommunications Union—

Chairman PERLMUTTER. Mr. Carrillo?

Mr. CARRILLO. —and is very important for future security. Thank you.

[The prepared statement of Mr. Carrillo can be found on page 67 of the appendix.]

Chairman PERLMUTTER. The gentleman's time has expired. Thank you, sir.

Professor Gerding, you are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF ERIK F. GERDING, PROFESSOR OF LAW, AND WOLF-NICHOL FELLOW, UNIVERSITY OF COLORADO LAW SCHOOL

Mr. GERDING. Thank you, Chairman Perlmutter, Ranking Member Luetkemeyer, Chairwoman Waters, Ranking Member McHenry, and members of the subcommittee for inviting me to testify today. My name is Erik Gerding. I am a law professor at the University of Colorado, where my research focuses on banking and securities laws. I will focus my testimony today on three things: first, the FDIC decision to reopen applications for deposit insurance for industrial loan companies; second, the OCC's radical new Fintech charter; and third, and more broadly, why banking law separates banking from commerce and commercial firms from banking.

That last issue came to a head in 2005 when Walmart applied to the FDIC for deposit insurance for a new ILC that Walmart was seeking to charter. Walmart's applications set off a political and legal firestorm. This firestorm is now threatening to re-erupt now that the FDIC and the OCC are reopening Pandora's Box through charters that would confer the powers and privileges of banks on non-banks. It is important that this committee look not just at initial applicants for charters because it is hard to see how the FDIC or OCC would come up with legally defensible distinctions that would keep out bigger companies like Amazon, Apple, Google, and Walmart from one or both of these non-bank bank charters.

But why do we separate banking from commerce? What is the harm in endowing banks with the powers and privileges of banking? The concerns are not just progressive but also deeply conservative concerns. We should worry about commercial firms using bank charters to undercut rivals without charters. We should worry about conglomerates in retail and tech using the powers and privileges of banks to entrench market-dominant positions. We should worry about small retailers and small startup tech firms not being able to compete with well-resourced and politically connected firms that have the powers of a government charter behind them.

We should worry equally about banking conglomerates competing unfairly in non-bank markets. We should also worry about whether small banks and credit unions can face distorted competition. Most troubling, we should worry about a banking system that could quickly devolve into being dominated by the three bigs: Big Wall Street; Big Tech; and Big Retail. We should, in short, worry about the core reasons that we separate commerce and banking: to prevent concentrations of economic and political power; to prevent distortions in commercial markets that allow unfair government-subsidized competition; and to prevent distortions in banking markets that could leave banking markets destabilized and without the smallest community banks and credit unions. Non-bank charters could thus undermine one of the core missions they are purported to serve: offering greater access to financial services for underserved communities. There are better ways to serve that goal.

I will turn quickly to the FDIC charter, because one thing I want the committee to understand is that it is important that ILC's are not subject to consolidated supervision by the Federal Reserve. Consolidated supervision is the cornerstone that allows bank regulators to ensure that large financial conglomerates, or large commercial conglomerates, are not playing games with subsidies that come with deposit insurance or the other powers and privileges of banking. Consolidated supervision is a world away from the ordinary supervision that the FDIC and the OCC apply to individual firms and institutions. That critical distinction is something that the committee must remember.

I would urge the committee to reverse the power grab by the OCC, and foreclose and preclude the OCC from issuing any new charters to institutions that do not accept deposits. I would also urge the committee to close the ILC loophole and pursue other options for greater access to banking by underserved communities.

[The prepared statement of Professor Gerding can be found on page 93 of the appendix.]

Chairman PERLMUTTER. Thank you, Professor, and the chime didn't go off, so you hit it right on 5 minutes. And obviously, the testimony of all of our panelists—they are dealing with the purpose of the banking system, the history of the banking system, and the future of the banking system. So, this is a very comprehensive and complex subject that we all have, and I would recommend to the committee that they really look deeply into the materials that have been provided.

Professor Johnson, you are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF KRISTIN JOHNSON, ASA GRIGGS CANDLER PROFESSOR OF LAW, EMORY UNIVERSITY SCHOOL OF LAW

Ms. JOHNSON. Thank you so much. Good morning, Chairwoman Waters, Chairman Perlmutter, Ranking Member Luetkemeyer, and members of the committee and the subcommittee. Thank you for inviting me to this hearing examining banking innovation and regulatory evasion, and trends in financial institution charters.

As the Chair mentioned, I am the Asa Griggs Candler Professor of Law at Emory University Law School where I teach courses on corporations securities law, emerging technologies, and financial markets, including the mouthful distributed digital ledger technologies, which we commonly describe as blockchain technologies, as well as the assemblage of technologies commonly described as artificial intelligence.

I previously served as the McGlinchey Stafford Professor of Law and Associate Dean of Faculty Research at Tulane University. That was also noted, but I also served as director of the program on financial market stability at the Center for Law and the Economy. And if I may, I am a reformed capital markets and mergers acquisitions lawyer and served as in-house counsel and an analyst at two of the largest investment banks in global financial markets. My research promotes transparent, inclusive, responsible innovation, and focuses on the core values of financial markets regulation: promoting consumer protection maintaining fair and orderly markets; and ensuring the safety and soundness of financial markets.

Over the last decade, a growing number of digital startups have launched bids to lure business away from the financial services industry. Increasingly, large technology platforms engaged in essentially commercial activities, as well as social media platforms, seek opportunities to conduct bank-like activities. Amazon, Google, and Facebook, among others, have launched a dizzying array of consumer credit and financial services.

To echo Mr. Carrillo, and also my colleague, Professor Gerding, these firms comprise a small subset of a burgeoning spectrum of businesses integrating complex technologies and financial services armed with vast quantities of data and sophisticated algorithms that would be supervised and unsupervised machine learning platforms. These are algorithms inspired also by the creation and potential of blockchain-based technologies. These Fintech firms have revived long-standing debates regarding the architectural design, regulatory framework, and role of the financial services industry.

This important hearing explores the nature of relationships among banking and non-banking financial institutions as well as the promise and peril or perils of extending special purpose nonbank charters to non-depository Fintech firms that do not engage in certain activities quintessentially understood as core banking functions as well as commercial firms seeking to obtain licenses to operate as industrial banks. As this committee discussed previously in a hearing in the fall, where Mr. Raul Castillo, who is here, and Professor Wilmart testified, the National Bank Act clearly limits the scope of the OCC's authority to issue Fintech charters to non-depository institutions.

To quote others who have written extensively and researched the history of banking regulation and the canons of statutory interpretation, “non-depository national bank” is an oxymoron. I am happy to say more, citing the National Bank Act, in particular Section 24, the OCC’s authority to extend charters. But I believe much of that is covered in the written testimony provided by witnesses today.

Coupled with the movement by the OCC to expand charters, the industrial loan companies chartering question has emerged as an essential issue in today’s hearing as well as in conversations and debates. Finally, this hearing, as the Chair has noted, covers a scope of financial technology firms and capture States that are issuing or distributing licenses for blockchain-based financial institutions or institutions custodying financial assets known as crypto assets also, so bank licenses to those entities as well.

In my remaining time, I want to point out just the following issue that is of tremendous concern. These entities are operating with the promise of inclusion, but this promise is often inaccurate, misleading, and in some instances, a misrepresentation. Where the promise of inclusion attaches to vulnerable unbanked and underbanked populations, consumers who are, in many instances, families in fragile financial circumstances, it is critical for us to carefully examine the truths behind the promises that have been made, and install guard rails which would ensure that any entity operating in the banking space is subject to sufficient regulatory oversight.

For families with fragile financial circumstances, as Mr. Carrillo pointed out, credit may serve as a lifeline, enabling consumers to meet short-term debt obligations and to pay for education, transportation, housing, medicine, child care, and even food. Without access to credit on fair and reasonable terms, it can be extraordinarily expensive to be poor.

I would also point out the surveillance questions and highlight that COVID-19 has amplified these concerns. In the remaining time, I just encourage the committee to support the limitation on banking charters and ILC licenses.

[The prepared statement of Professor Johnson can be found on page 122 of the appendix.]

Chairman PERLMUTTER. Thank you, Professor.

Mr. Pacheco, you are now recognized for 5 minutes to give an oral presentation of your testimony. Thank you.

STATEMENT OF CARLOS PACHECO, CEO, PREMIER MEMBERS CREDIT UNION, ON BEHALF OF THE NATIONAL ASSOCIATION OF FEDERALLY-INSURED CREDIT UNIONS (NAFCU)

Mr. PACHECO. Good morning, Chairman Perlmutter, Ranking Member Luetkemeyer, and members of the subcommittee. My name is Carlos Pacheco. I am the CEO of Premier Members Credit Union headquartered in Boulder, Colorado. I am pleased to be joining you today on behalf of NAFCU to share our views on the trends in financial institution charters.

The nation’s approximately 5,000 federally-insured credit unions serve a different purpose and have a fundamentally different structure than other types of financial institutions. As not-for-profits existing solely to provide financial services to our members, we are pleased to be on the front lines working with our members to help them survive the economic uncertainty from the pandemic.

The growth of financial technology in recent years offers new opportunities for the delivery of financial services. The use of Fintech can have a positive effect on credit union membership. Many credit unions embrace innovations and technology in order to improve member relationships and NAFCU believes that this is important for regulators like the National Credit Union Association (NCUA) to ensure that credit unions have the proper authority in this space under their charters.

However, the growth of Fintech also presents threats and challenges as new entities emerge in an environment that can be underregulated or undersupervised. As such, when Fintechs compete with regulated financial institutions, they must do so on a level playing field. While many Fintechs are still subject to various consumer protection and other laws, they are not examined, nor do they face the same oversight as other players in the financial services marketplace, creating cracks in the system that could pose risks to both consumers and the financial system.

For example, underregulation of Fintech companies can place a greater burden on credit unions' efforts to protect deposit accounts. As a primary financial institution for our members, we are often the preferred party for resolving issues involving unauthorized transactions even when they occur on other platforms. While credit union consumer complaint processes are overseen by regulators, there is no comparable oversight for Fintech companies that facilitate payment transactions, even in instances where they share responsibility for resolving errors under Reg E. A minimally staffed call center may be all it takes to steer financial Fintech users to the credit union if there is a problem, and that alone can create competitive imbalance.

There has been a recent trend in which Fintech companies are enjoying liberalization of banking charter rules to either acquire or become banks. Recent developments with both the OCC's new chartering options and the FDIC's chartering and approval of deposit insurance for a new wave of industrial loan companies also present problems. In each case, a non-bank company can potentially evade regulation under the Bank Holding Company Act (BHCA) either because of a statutory loophole unique to ILCs, or because the entity is seeking a limited-purpose charter and will not accept deposits.

Lack of BHCA coverage raises concerns regarding the quality and extent of supervision for these specialized banking entities. In certain cases, specialized limited-purpose bank charters may allow a Fintech to operate with national banking privileges, but without the same prudential safeguards that apply to traditional banks and credit unions. While some may characterize these chartering initiatives as innovative, they invite the potential for underregulation of novel risks and could create an uneven playing field.

Depending on the scale or risk of activities, which might involve facilitating cryptocurrency transactions, lack of consolidated supervision by the Federal Reserve could create additional financial stability risks. To address these concerns, NAFCU supports steps such as imposing a moratorium on new ILC charter approvals by the FDIC and closing the Bank Holding Company Act loophole for existing ILCs. It is also important that existing charters, such as those for credit unions, are kept up-to-date to meet member needs.

Congress should also ensure that the data security and privacy requirements for financial institutions in the Gramm-Leach-Bliley Act, including supervision for compliance, apply to all who are handling consumer financial transactions.

Regulators also have an important role to play. For example, the Consumer Financial Protection Bureau (CFPB) should use its "larger participants" authority to regulate and supervise technology firms and Fintech companies that enter into the financial services marketplace. New chartering ideas should also be subject to the notice and comment rulemaking process. Congress should also consider creating a Federal Financial Institutions Examination Council (FFIEC) subcommittee on emerging technology to monitor the risks posed by Fintech companies and develop a joint approach for facilitating innovation and identifying regulatory gaps between new and existing charter options.

In conclusion, credit unions look forward to continuing to experience growth in the technology space as a way for us to better serve our members. However, as technology companies expand and new charters emerge to compete in the financial services marketplace, it is important that they compete on a level playing field of regulation and supervision. Finally, it is important that Congress ensures that laws are modernized to allow credit unions to keep up and compete with technological advances. I thank you for the opportunity to appear before you today, and I welcome any questions you may have.

[The prepared statement of Mr. Pacheco can be found on page 153 of the appendix.]

Chairman PERLMUTTER. Thank you, Mr. Pacheco. Is it snowing in Colorado?

Mr. PACHECO. Not at this hour, but maybe in the next hour.

Chairman PERLMUTTER. Okay. Thank you.

Mr. Brooks, you are now recognized for 5 minutes for your oral testimony.

STATEMENT OF BRIAN P. BROOKS, FORMER ACTING COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)

Mr. BROOKS. Chairwoman Waters, Ranking Member McHenry, my fellow Coloradan, Chairman Perlmutter, and Ranking Member Luetkemeyer, thank you so much for the opportunity to speak today. I will say at the outset, I am the only representative of southern Colorado here, so we can have that conversation afterwards.

Let me just say we are fortunate to live in a moment of extraordinary innovation that I believe can actually expand access to credit, provide consumers greater economic opportunity, and provide a more just and robust economy. As policymakers and participants in this evolution of the financial services industry, we have a responsibility to encourage responsible innovation while maintaining necessary safeguards to ensure that our system operates in the safest, soundest, and fairest way possible.

Now, while my testimony goes into greater detail regarding what is driving the changes in our financial system and the implications for chartering innovative financial companies, I want to highlight a few thoughts in these remarks.

First, the rise of non-bank financial services providers, and in particular Fintechs, is the result of market forces that include the dramatic reduction of banks and branches, as has been noted already, which is felt most in rural and urban, low- and moderate-income communities. And at the same time as consolidation, regulatory forces made certain consumer lending less attractive for traditional banks, and that business migrated toward non-bank providers such as payday lenders. It is against that backdrop that we think that innovative technology emerged, allowing Fintech companies to develop solutions that provide consumers better alternatives to traditional banks on the one hand, and strip mall financiers like payday lenders on the other. The new products provide more convenience, greater accessibility, and are often tailored more closely to consumers' personal needs and situations. Fintechs also emerged to provide back-office solutions such as payments processing that operate more efficiently than comparable systems in the legacy of banks.

As a result, many products, services, and activities that were once exclusive to banks now occur outside of the banking system. Where once that activity was watched closely by bank regulators, today much of it goes on outside their view. The questions that this hearing asks are whether those companies, which undeniably are providing banking products and services that historically were provided by banks, should have an equal means to compete with incumbent banks as chartered institutions and whether providing a path for these service providers to become banks can be done in a safe, sound, and fair manner.

Based on my experience and analysis, it is both necessary and advantageous to support a dual banking system of State and Federal banks in which companies with novel and unique business models, powered by ever-improving technology, can compete with incumbents on a level playing field. By providing a path and allowing choice for innovators to become part of the chartered banking system, the system avoids stagnation, evolves to better meet consumer preferences, and to address business and community needs.

That view previously enjoyed bipartisan champions, because it is a safe and sound and thoughtful position that puts the good of the nation first, and recognizes that the failure to encourage responsible innovation and to welcome new participants into the banking system, stifles the system, making it both anachronistic and concentrated in the hands of legacy large institutions, which have been criticized on a bipartisan basis as well. After all, Fintechs have not emerged because the status quo had satisfactorily met all the needs of the economy or all the needs of consumers.

I am optimistic about the progress being made to overcome bias and irrational fears toward innovative ways of meeting consumers' financial needs, including progress made in transforming cryptocurrencies and blockchain applications from exotic concepts to more mainstream financial and economic tools. I am proud to have been involved in chartering the first true Fintech company, Varo Bank, which has helped clarify national bank regulations as they relate to digital assets and stable coins. These actions have expanded services to consumers, they have allowed existing banks to explore how emerging technologies can be incorporated into their strategies of serving their customers, and they have helped provide a meaningful counterweight to the concentrated power of the largest banks in our system.

Still, more rigorous [inaudible] needs to be done on other important issues, particularly the appropriate measure of a sustainably profitable Fintech's contribution and obligation to its community whether it becomes a chartered bank or not. While depositories, for example, are subject to the Community Reinvestment Act (CRA) and its important civil rights provisions, Congress did not apply the CRA to non-depository financial services providers. Policymakers thinking about chartering these non-depositories should explore alternatives to the CRA that consider other advantages that federally-chartered or State-licensed non-depository financial companies enjoy, and what obligation that may entail to meet the important economic justice and civil rights spirit of the CRA.

Recognizing that the economic inequities of the nation require the removal of barriers in addition to reinvestment, I founded Project REACH at the OCC in July 2020 to explore ways that technology innovators, banks, and civil rights leaders can work together to solve the structural issues behind race disparities, including the fact that large numbers of minorities lack usable credit scores and have more difficulty than others in saving for a house down payment. Fintech has something to say about all of these things, and if we believe that an unregulated Fintech poses challenges, we should welcome them into the regular system. Thank you, Mr. Chairman.

[The prepared statement of Mr. Brooks can be found on page 48 of the appendix.]

Chairman PERLMUTTER. Thank you, Mr. Brooks.

And thank you to all of our panelists.

I now recognize myself for 5 minutes for questions. I guess, obviously, just looking at the written materials that you all provided and coupled with your testimony, we really are dealing with the length and breadth of the financial services system, the banking system, its purpose, its history, and its future. And maybe we need to have a couple of follow-on hearings after this because each of us is going to come at this with our life experience.

I am coming at it as a bankruptcy lawyer of 25 years, who saw a lot of cycles where businesses failed and banks failed, in Colorado and Texas. Mr. Williams, we saw pretty much every single savings and loan fail. But then we saw things grow and expand again, and we saw another cycle. And so I disagree with Mr. McHenry that, gee whiz, we are doing this all over again. It is because the system grows and shrinks, and it gets excesses and not, and we have to just determine how, as a policy matter—and I don't think this breaks along any party lines as to whether you're conservative about the system or you want to see it expand and take on some additional risk. All of us need to chart the path we want to see our banking system follow over the next 10 to 15 years. And I think that is the purpose of today's hearing, and as we go forward.

One of the big questions on industrial loan companies (ILCs) is about the separation of banking and commerce. And in 2005–2006, Walmart and Home Depot unsuccessfully pursued ILC charters. There was a great deal of scrutiny from lawmakers in the public about large retail corporations offering banking services and what it could mean for market fairness and financial stability. Last December, the FDIC published a rule on ILCs, clarifying that the parent company of the industrial bank must serve as a source of strength for the industrial bank.

Professor Gerding, how well-suited is the FDIC, or any other regulator, to assess the strength of a commercial company, and do you have concerns about the continued blending of commerce and banking?

Mr. GERDING. Thank you, Chairman Perlmutter. I have grave concerns about the ability of the FDIC to supervise ILCs and their parents. This goes back to what I said at the end of my remarks. The FDIC does not have the authority to conduct consolidated supervision over not just the ILC and its parent, but all other entities within the corporate group. And that lack of consolidated supervisory power does not allow the FDIC to see potential gains that conglomerates are playing with FDIC subsidized financing. It also does not allow the FDIC to see the buildup of risks within the conglomerate. And this became a problem when in the financial crisis when we saw the parents of several ILCs require billions of dollars of government assistance; Goldman Sachs, CIT, Merrill Lynch, Morgan Stanley, GE Capital, and GMAC all had ILCs. All of those parents did not serve as a source of strength for their ILCs, and then, by contrast, actually required billions of dollars of government intervention. So, I don't think that the source-of-strength argument gives us much comfort.

Chairman PERLMUTTER. Thank you.

Professor Johnson, I would like to ask you a question. In 2019, the State of Wyoming enacted a series of laws related to cryptocurrency, including one authorizing the chartering of special purpose depository institutions (SPDIs). Last year, Wyoming approved the first SPDI charters for Kraken Bank and Ivani Bank, two cryptocurrency custodial firms planning to offer services.

It seems many cryptocurrency companies are eager for a legal framework in which to operate. Do you believe bank charters are the appropriate framework for these firms?

Ms. JOHNSON. Thanks so much for the question, Mr. Chairman. I would echo Professor Gerding's comments and amplify them. During the financial crisis of 2008, we not only saw these challenges that were endogenous with respect to regulated firms, but exogenous challenges as well that triggered systemic risks that created losses across financial markets. I would encourage a very careful evaluation of any extension of charters to cryptocurrency-based firms because of the endogenous and exogenous shocks that could create systemic risks and destabilize financial markets.

Chairman PERLMUTTER. Thank you, Professor.

My time has expired. I now recognize the ranking member of the subcommittee, the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman, and just as a comment, the title of this hearing is, "Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters," and yet we have no representation from the banks here today. We have several bank think-tank guys and professors and whatever, but we have nobody representing any of the associations or any of the banks themselves. I am kind of wondering about that. But anyway, it is always nice to have somebody from the real world.

Chairman PERLMUTTER. If the gentleman would yield for one second, I think that is why we we may have to have a couple more hearings on this.

Mr. LUETKEMEYER. Okay. That would be great. We look forward to having a real-world aspect on this as well, besides the theoretical part of this.

Mr. Brooks, I want to start with you. Again, I appreciate your service to our country as a Comptroller. I think you did a fantastic job and I look forward to continuing to work with you on the private sector side here.

In your testimony, you discussed how the scope of a bank charter can adjust to accommodate the safe and sound delivery of traditional banking products and services by companies that are not charters banks today. Do you think there is a way to provide a level playing field for traditional depositories and non-banks that are providing the same services and products without requiring the non-banks to get a full national bank charter and follow all the rules and regulations?

Mr. BROOKS. Let me just say, Mr. Luetkemeyer, first of all, I very much appreciated your engagement. During my time at the OCC, we have had some of these conversations privately, and let me just expand on that and answer your question. I think the answer is that we have seen on a fairly secular basis over the last 10 years an unbundling of financial services that used to be delivered together, and people want them delivered differently today. So the question really isn't, do we need to create some new frameworks, the question is, if you have activities that have always been conducted by banks and are clearly permissible to banks and are part of the core of banking services, then the question is, why do they stop being banks when they choose to only offer some financial services?

The way I think about the level-playing-field question is if Bank of America offers a payment-processing service that is subject to an examination module that the OCC has for payment processors, and if Square is also providing a payment-processing service, it ought to be allowed to elect to be subject to the very same supervision.

I think the red herring in the discussion often is the idea that somehow it is not a level playing field because Square wouldn't also be subject to deposit regulation or any of a suite of other regulations. But what I think of when I think of that issue is, when I was a kid growing up in Pueblo, Colorado, I had my bank account at a small thrift in Pueblo called American Federal Savings. American Federal Savings was a bank. They were regulated by the Office of Thrift Supervision (OTS), but somehow they weren't subject to commodities and derivatives regulation like JPMorgan was, not because there was an unlevel playing field, but because American Federal Savings didn't offer commodities and derivatives. So for what they did, they were subject to the very same rules and regulations as the analogous services provided at JPMorgan, but there were some things they elected not to provide, so they weren't subject to those things, and that is not an unlevel playing field.

My belief is that anything that is a banking service can be accommodated inside of one of the several existing bank charters without the need for radical innovation. To me, that is common sense.

Mr. LUETKEMEYER. Okay. Dr. Gerding made a comment here a minute ago with regards to the separation of banks from commerce. In his written testimony, he says that preventing consolidation of credit, the concentration of economic power, and the concentration of political power—and to me, this is why we had this situation for 60 years, and we have slowly gotten away from it. And to me, this is where you get the question on the ILCs, do we want to allow another commercial entity to own a banking entity, financial services entity, and let them creep into, from the commercial side of this, the banking sector? [Inaudible] to address that? Give me your thoughts on that?

Mr. BROOKS. Yes. This is another place where I apologize. Were you asking me, Representative Luetkemeyer, or were you asking Professor Gerding?

Mr. LUETKEMEYER. Mr. Brooks, yes. I cornered Mr. Gerding because it really, I think, encapsulizes the concerns that some of the folks like myself have, that for 60 years, we kept the banking and commercial stuff apart, and now we are allowing it to get mingled together, and every day it gets mingled more and more. And I think the ILC question is one that really solidifies this question of, do you allow the commercial folks to get into the banking or not?

Mr. BROOKS. Yes. What I have always said about that is it is a very different question to ask, should Walmart be able to get an ILC, versus should a firm or Brex, which are lending companies, be able to get an ILC charter? I don't think the Walmart question is presented. I am not personally comfortable with that, and I think throwing the babies out with the bathwater on that might be a mistake.

Mr. LUETKEMEYER. Okay. Thank you very much.

I yield back, Mr. Chairman.

Chairman PERLMUTTER. Thank you. The gentleman's time has expired.

And I would say to Mr. Brooks, it is a good thing you don't have an account at American Federal, because it is one of the many savings and loans that failed back in the late 1980s and early 1990s.

Mr. BROOKS. Very true.

Chairman PERLMUTTER. I now turn to the former chairman of our subcommittee, Mr. Meeks from New York, for 5 minutes.

Mr. MEEKS. I want to thank you, Mr. Chairman, and Ranking Member Luetkemeyer, for having this very important and critical hearing. Just listening to the testimony of the witnesses and some of the early questions from both you and Mr. Luetkemeyer is really important. And I understand, also, that there is a debate as to whether the National Bank Act requires nationally chartered institutions to take deposits. I know the courts will decide that, but look, I go back and forth myself, because one of the things that I know is that sometimes what we did 20, 30, or 40 years ago because of technology or because of changes, we have to look at it again and figure out, how do we do certain things that push us forward?

And I get the questions, and I want to make sure that we still have regulatory authority so that people don't run away with, in an unprotected way with—because of technology, but I also want to make sure that access to capital is available to many small businesses like the small businesses in my community. I talk to many minority-owned small businesses, et cetera, and they tell me that the number-one issue that they have is access to capital.

I have seen the banking industry consolidate over the last 20 years while technology is now allowing for new entrants in the financial services area. And there are serious concerns that the Big Tech companies could enter the financial system by the ILC regime, concerns that I definitely share with banks and consumer groups alike. And then, if the large non-financial companies can receive ILC charters, these companies could potentially receive all of the banking privileges without having to answer to the same prudential standards as traditional banks including, for example, Minority Depository Institutions (MDIs) and Community Development Financial Institutions (CDFIs).

I also have the anti-trust concerns when it comes to the prospect of large, non-financial companies entering the system through ILC regimes. I will start with Mr. Gerding, and then maybe Mr. Pacheco can jump in also. Given that the FDIC is beginning to accept applications for new ILCs for deposit insurance, can you speak to whether and how such entrants would have a competitive advantage over, for example, credit unions or minority banks?

Mr. GERDING. They have an advantage in several ways. On the one hand, they would get the benefits of FDIC deposit insurance, which would allow them a cheaper cost of financing, which they could then spread to other parts of their corporate conglomerate. That kind of gain with FDIC insurance would allow them to undercut commercial rivals. It would also allow them to enter into a banking realm with all of the powers and privileges of banking, then undercut credit, and small credit unions, and small community banks. And again, they would not be subject, as you said, Representative Meeks, to the same level of prudential regulation and that same all-important consolidated supervision that traditional banks are subject to.

Mr. MEEKS. Thank you.

I am going to come to you, Mr. Pacheco, but let me go to Mr. Brooks really quickly to ask, how do you counter that, what Mr. Gerding just said?

Mr. BROOKS. The issue I see, Congressman Meeks, is the idea that I think all of us here on the panel today are concerned about the level of concentrated power that the biggest banks have. And so, I am a believer that new entrants, whether they are Fintechs or other kinds of companies, as long as they meet the statutory requirements, are a counterbalance to that. So again, one of the points of Project REACH was to find ways of bringing technology companies into the solution for, why isn't there more capital available in inner-city neighborhoods, and why have banks pulled more branches out of inner-city neighborhoods than out of rich suburbs?

Somebody has to fill that void. It hasn't been the big banks, so it needs to be somebody. And to me, the safest way to do that is not to allow Fintechs to do it on a completely unsupervised and unregulated basis; it is to bring them into the fold subject to supervision. That is sort of the common-sense solution.

Mr. MEEKS. Let me allow Mr. Pacheco to jump in there,

Mr. PACHECO. I appreciate that. Thank you for the question, Congressman. I would say that I agree with some of the testimony from Professor Gerding and Mr. Brooks. My one deviation from that is that organizations like credit unions my size, a small organization with just a billion and a half in assets, is out there going into those communities that might have been left behind by other institutions. We are out there building relationships in places like Pueblo and other parts of Colorado.

Mr. MEEKS. I am out of time.

Thank you, Mr. Chairman.

Chairman PERLMUTTER. Thank you, Mr. Meeks.

The Chair recognizes the gentleman from Kentucky, Mr. Barr, for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman. And as my friend, Mr. Meeks, focused on urban banking deserts, let me ask a few questions about rural banking deserts, and in particular, the decline in de novo charters. Since the financial crisis, de novo formation has slowed significantly. There were 181 charters granted in 2007, but between 2010 and 2019, fewer than 10 new banks, on average, opened per year. More than half of the counties in the United States saw net declines in the number of bank branches between 2012 and 2017. These declines in bank branches disproportionately hit rural communities.

The negative financial impacts on rural counties of bank branch closures are perpetuated by continuing difficulties due to burdensome regulations and other roadblocks of de novo community bank formation. These trends leave residents of rural counties without access to much-needed financial services and also have negative downstream impacts on those communities. I am trying to remedy that by introducing today the Promoting Access to Capital in Underbanked Communities Act, which would encourage formation of new banks in locations where bank branches are scarce. It would give de novo banks more time to meet capital requirements and ease other regulatory burdens on new community financial institutions.

Mr. Brooks, I share Mr. Luetkemeyer's appraisal of your service at the OCC; I also enjoyed working with you. Can you tell us what some of the biggest roadblocks are to de novo bank formation?

Mr. BROOKS. Thank you, Congressman Barr. I very much have appreciated our relationship and your mentorship and guidance, so thanks for the opportunity. I would just begin by saying that as in many things, process in government is everything. And so, when I first arrived at the OCC and looked at the bank chartering process, the process flow involved, doing that involved something like 58 steps. I am making that number up. It was a huge number of steps where multiple committees had to review charter applications more than one time and that was just one of the three agencies that charter banks. So I think part of the problem is that we have to streamline the process by making clear how one gets a de novo charter and making clear what the timeline expectations are for getting those things approved even just inside of the charter agencies of the OCC.

The second thing I would say to this committee is we have an incredibly complicated process where three different agencies have full discretion over whether to approve or not approve banks, because once you have a national bank charter approved at the FDIC, you still need deposit insurance approval, and nowadays the Federal Reserve is exercising extraordinary oversight over whether something that has been approved by those two agencies should be allowed to become a FIN member. That is why it took Varo Bank nearly 3 years from initial approach to charter grant, and we can't have the kind of system we had in the 1980s and 1990s if we are going to take 3 years to charter every bank.

So I share your concern that finding ways to shortcut that process, not in the sense of shortcutting important substantive requirements, but shortcutting bureaucratic red tape, which takes an enormous amount of time for a good purpose is really important.

The other thing I would tell you is in rural communities, Fintechs are the main source of credit, in certain respects. If you want to get a mortgage in Versailles, Kentucky, you are not going to get it at a local branch. What you are going to do is find it on LendingTree, and that is why it is more important that those companies be encouraged and regulated, so that they can deliver those services more effectively in places where banks don't have branches.

Mr. BARR. That is good feedback. I will note a recent study from the FDIC which found that citizens in rural communities are more likely than people in urban or suburban areas to visit bank branches. Obviously, you mentioned some online opportunities. Of course, rural broadband is a challenge for mobile banking. I have introduced bills to combat both of these issues, but the problems have been exacerbated by the pandemic. Is there anything else we can do to increase access to the banking system for rural populations?

Mr. BROOKS. I would say, Congressman, that consistent with the bill that you are introducing today, we need to have a concept kind of like a CRA-type of concept, where if you are serving an underbanked community, there needs to be a fast track to approval. And I think you and I have talked before about the fact that there are rural communities in Kentucky and Mississippi and other parts of the south where the nearest bank branch is 75 miles away. So the only way you are going to allow those local community leaders to form new branches, is if there is a fast-track option. And we should see that as community reinvestment—

Mr. BARR. Really quickly, Mr. Brooks, in my final few seconds, can you address Professor Johnson's analysis that a non-depository national bank is an oxymoron?

Mr. BROOKS. In the National Bank Act, deposit taking is a power of a bank, not a requirement. It is a requirement in the Bank Holding Company Act, but it is a power, not a requirement in the National Bank Act.

Mr. BARR. My time has expired. I appreciate the answers, and I yield back.

Chairman PERLMUTTER. I thank the gentleman for his questions.

I now recognize the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Thank you. I would like to first talk about the industrial loan company loophole to what has been in this country—can I be heard?

Chairman PERLMUTTER. You are live and loud.

Mr. SHERMAN. Live and loud. Thank you.

I would like to first look at the industrial loan company loophole to what has been a prohibition in this country of mixing industry and commerce on the one hand, and financial services on the other. Now, a couple of decades ago, we did allow different types of financial services companies to be under one roof. An insurance company can also own a bank or vice versa.

But, Mr. Carrillo, last month it was reported that Walmart had hired a Goldman Sachs head of consumer banking and announced a partnership with Reddit Capital, trying to expand into financial services. Walmart and other major retailers have, at various times, sought State-issued industrial loan company charters. Just as the Trump Administration was on its way out the door in December of last year, the FDIC adopted rules that paved the way for nonbanks to own ILC-chartered banks, and here is the key part, without being subject to the same regulatory oversight requirements that are applied to traditional bank holding companies.

Do you see inconsistencies in these regulatory requirements, and is it a good idea for us to copy a system that has done tremendous damage to Japan of having groups of companies that are in both industry and commerce on the one hand, and financial services on the other?

Mr. CARRILLO. Thank you for your question, Congressman Sherman. I believe that the Japanese example does provide some lessons. They call Rakuten, "Japan's Amazon," and it has integrated into financial services in a way that it will never be untwisted at this point. I do want to highlight one dimension regarding the ILC issue that Professor Gerding and Professor Johnson did not hit on, although I believe they both point to it, at least in the general way, in their testimony as well. It is that a lot of these companies that will come through this loophole will be subject to different data collection requirements. They will not be subject to Regulation Y or the regulations of the BHCA in the same way, and they won't even provide the limited privacy protections that current banks do to their customers.

So, in many ways, this is replicating the problems of the past, as Ranking Member McHenry said, in the sense that we are creating things that look like deposits, act like deposits, walk like deposits, and talk like deposits, but we don't treat them like deposits. And in the other sense, this is totally new and [inaudible]

Mr. SHERMAN. And following up on that, we have a few very small, old ILCs out there, but if Amazon exploits this, they are going to be enormous; they don't do anything small. And the question then would be, would they be subject to the Financial Stability

Oversight Council (FSOC) if they were of systemic importance to our financial system?

Mr. CARRILLO. Yes. There are all of these giant macro questions, which I believe Professor Gerding outlined quite well. And the issue, to me, is certainly one of power even behind that. And, Congressman Sherman, the issue is that entities like Amazon and Facebook and Walmart, which launched the Fintech, as you said, and has hired people from outfits that don't respect privacy to come in under the cloak of providing access to credit or financial inclusion even, but to do so in a way that fundamentally depends upon mass surveillance and a violation of our constitutional rights consistently.

There are other ways to do this in which we respect privacy. There are other ways even for private sector companies to do this, let alone the government itself, and we are not addressing those ways. I would be really interested to hear what, for instance, former acting Comptroller Brooks has to say about the Fourth Amendment, and again, the necessary violation of privacy that is the business model of these companies [inaudible].

Mr. SHERMAN. I do want to go on to one other issue, and Professor Gerding, I am probably going to ask you to respond for the record. But we see that the State of Wyoming is moving toward cryptocurrencies and the OCC has granted preliminary approval to the Anchorage Trust Company to become a national trust bank, and Anchorage, of course, claims to be a cryptocurrency asset custodian. I have looked at Bitcoin and wondered whether there was a big enough market among terrorists and drug dealers, and it didn't seem to be enough. And then, I realized, when the IRS Commissioner testified to one trillion dollars every year of unreported taxes, chiefly from the wealthy that—and I made up a little advertising sign that may help Anchorage: "Bitcoin, it is not just for terrorists anymore; it is for tax evaders, too." That is the market for Bitcoin. I yield back.

Chairman PERLMUTTER. The gentleman yields back.

The gentleman from Texas, Mr. Williams, is recognized for 5 minutes.

Mr. WILLIAMS OF TEXAS. Thank you, Mr. Chairman. I think one of the greatest exports America has are the products and services that our entrepreneurs and businesses bring to the marketplace and share with the world. I do not want to run the risk of losing our position as the world leader in innovation. That being said, I do not think we should have to, or quite frankly need to, add additional risk into the financial system to help foster the business-friendly regulatory environment that we meet.

Mr. Brooks, I also want to add thank you for your service to our country, and I also would address my first question to you: How would eliminating access to chartering options like an ILC impact Fintech companies from innovating and creating new products and services, and do you believe that these companies would just move to other jurisdictions outside of the U.S. that provide a more modernized regulatory system?

Mr. BROOKS. Congressman, I really appreciate that question, and I guess I would answer in two different ways. Before we talk about offshoring technology, which is a real risk, let's just talk about the actual companies that are actually applying for ILC charters today. They are not Walmart. They are not Google. They are financial companies. They are a firm, which is a point-of-sale lending company that is one of the largest companies in that space today and all they do is make loans. That is their entire business. They would like to be an ILC.

So, you have two choices in that world. That company can come into the ILC world and be supervised by a State regulator and by the FDIC or not. Okay? And the question is, which is a riskier scenario? Letting them in the system so they can be supervised, and remember that the federally-supervised entities fail at about half the rate of non-federally supervised entities, or we can keep them out of the system. Today, I would argue that it is riskier.

Now, if the U.S. adopts the anti-tech posture, and I think one of the comments made earlier is that we can't take the politics out of tech, what you already see is significant aspects of tech moving offshore primarily to Asia, but even to markets with somewhat more unified financial regulation like the U.K.

Comments have been made about cryptocurrency. Obviously, I disagree that the market for Bitcoin is terrorists and tax evaders; we could have that conversation separately. But the position we have taken in this country thus far about blockchain and its opportunities has been a position that has led many exchanges to leave the United States.

Now, there is optimism, because of the Coinbase IPO yesterday, that the U.S. markets are very welcoming of that business, but increasingly that activity is going to the U.K., the EU, and Singapore. And those are countries that still have an idea that perhaps responsible innovation with an appropriate amount of risk oversight is a good thing, not a bad thing. So I think we need to think carefully about that.

Mr. WILLIAMS OF TEXAS. I appreciate that answer. My office has been contacted by a variety of stakeholders talking about the importance of the True Lender Rule. The fact that it is being discussed as something that could be invalidated with the Congressional Review Act has already caused some market participants to get nervous as they are working to provide services to banks with which they have partnered. I think that when some of my Democratic colleagues try to simplify the rule down to saying it is just a rent-a-charter scheme, it missed the intention of the rule.

So, Mr. Brooks, again, can you talk to us about how the True Lender Rules assist the OCC in protecting the safety and stability of our nationally chartered banks?

Mr. BROOKS. Congressman that is a great question. And there were two motivations behind the True Lender Rule and its companion rule, the Valid When Made Rule. The first idea was that when the *Madden* decision came down in the Second Circuit Court of Appeals, lending to low- and moderate-income people living in New York and Connecticut, the States subject to that rule, fell by 64 percent. Let me just say that again. When you don't have the Valid When Made Rule, the people who get hurt are poor people. And the point of the rule was to reinstate access to credit for those low- and moderate-income Americans, our brothers and sisters, who were cut off from credit when banks weren't allowed to sell loans in the secondary market. That was the first reason.

The second thing we did in that rule is make very clear that rent-a-charter schemes of the past, which were all about the idea that nobody was accountable for those loans, not the bank and not the Fintech marketing partner, those were over. What we said in our rule was that in the True Lender regime, if the bank is the True Lender on the loan, it will be responsible for all disclosure, all anti-discrimination rules, all consumer protections. We eliminated rent-a-charter in that rule. So, it is a nice talking point to say that somehow this incentivizes rent-a-charter, but in fact, the text of the rule solves rent-a-charter and staff and career—supervisors at the agency worked very hard to make sure that was the case.

Mr. WILLIAMS OF TEXAS. Thank you for that.

And, Mr. Chairman, I yield back.

Chairman PERLMUTTER. Thank you, Mr. Williams.

Another gentleman from Texas, Mr. Green, is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. I greatly appreciate the opportunity to be heard, and I greatly appreciate you having this hearing; it is very valuable to me. Let me start with Coinbase and their predicate for where I would like to ultimately start. Coinbase made its market debut on Wednesday, and its reference price was $250. It ended up closing at $328.28. The value of the company is at $85.7 billion. For those, I am sure you know, but some may not know that Coinbase is a business that allows its clients, its customers, to buy and sell digital currency.

I mention this, because it is just a matter of coincidence I suppose, and I don't want to demean anybody but Mr. Bernie Madoff—and he passed yesterday. Mr. Bernie Madoff, for those who may have forgotten, was the father of a $20 billion Ponzi scheme. A lot of people have consternation about digital currency, cryptocurrency, because they are concerned that it might end up being a Ponzi scheme. This is a fear that people have, people who don't understand maybe, but some who do understand are very much concerned.

But my concern is this. When Mr. Madoff made off with this money, persons who, generally speaking, could care less about what Congress does as long as Congress kind of stays out of their business, made their way to Congress and they wanted Congress to help. They thought we should have regulated to the extent that this fraud should not have occurred. And I think that a lot of our concern and consternation with cryptocurrency emanates from people who saw what happened and still are concerned about what may happen.

So, here is my first question, and I would like to direct this question to Mr. Brooks. Is cryptocurrency an asset class or is it a substitute for currency? How do you see it? And can you just give me a quick answer? Maybe 10, 15 seconds, because I have another question for you.

Mr. BROOKS. Sure. Congressman Green, I really appreciate the question. I separate crypto into two worlds: Bitcoin and everything else. Bitcoin, I think of as an asset class. It is an anti-inflationary asset class that some people believe is a counterweight to inflationary monetary policy by governments. All of the other cryptocurrencies that exist out there are designed to create networks. They are essentially inducements to create internets on which various values can be exchanged. I am happy to talk more about that, but it is an internet protocol that has nothing to do with Ponzi schemes. And tell me how much time you want; I can give you more information on that.

Mr. GREEN. I appreciate what you have said thus far, but let me move forward. The American dollar is backed by the full faith and credit of the United States of America. That is a fair statement I think. Cryptocurrencies seem to be backed by the people who hold cryptocurrency. Is that a fair statement?

Mr. BROOKS. I don't think so, actually. I think I probably disagree with both of those statements.

Mr. GREEN. Explain, please?

Mr. BROOKS. Okay. So, what is backed by the full faith and credit of the United States is U.S. debt. A dollar bill is not U.S. debt. A dollar bill is just a unit of exchange which you use to buy things. If you look at what has happened in monetary policy over the last 12 months, the U.S. has increased the M2 money supply by 40 percent, which inherently devalues the amount of the purchasing power of the dollar. You saw that in the inflation reports that were in this morning's newspapers. So, that is an example of the dollar not being backed by the full faith and credit; it is backed by American monetary policy at any given moment. So. there is that.

Mr. GREEN. What about the cryptocurrency, if you would, please?

Mr. BROOKS. Right. So cryptocurrency, and again, put Bitcoin aside for just a moment. What cryptocurrency is about is the belief that a particular network will gain adoption. So when you buy an Ethereum token, an Eth token, that is like saying, I believe this network, which is a smart contract protocol for building financial applications, basically apps like on your cell phone, is going to have value. So if you think Google stock has value, because you think internet traffic is going to go up and Google is a tracking stock for the internet, buying Eth tokens is like believing that the Ethereum protocol will become the default protocol for financial applications. That is what it is backed by, adoption rates of that protocol.

Mr. GREEN. But if it is backed by the belief, and I do concur with this, is there the possibility of believers at some point no longer believing they can take it to zero?

Mr. BROOKS. Sure. Just as believers, in general, can say, that was the past, and this is the future, so I am dumping my General Motors stock. That can happen, too.

Mr. GREEN. Thank you very much. My time has expired.

Mr. CARRILLO. Representative Green, may I clarify a point of law?

Mr. GREEN. Well, the chairman would have to allow you to do so. My time is—

Chairman PERLMUTTER. Without objection, you have 30 seconds.

Mr. CARRILLO. Thank you. Former Acting Comptroller Brooks said that the U.S. dollar is not government debt. That is incorrect. It is an issue of the U.S. Federal Reserve. It is classified as a liability on its balance sheet. It comes from an instrumentality of Congress, although it is not considered under the debt ceiling to be treated the same way as a U.S. Treasury. It is very much a debt of the United States Government. It is money we owe to ourselves. It is our main payment tool constitutionally and administratively. Thank you.

Chairman PERLMUTTER. I thank the gentleman.

Next, we have the gentleman from Georgia, Mr. Loudermilk, for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman.

And, Mr. Brooks, before I get in my questions I just want to know if you needed a moment or a few seconds to respond to the previous gentleman?

Mr. BROOKS. Yes. I guess all I would say on that is that dollars are created by government credit operations, and so the underlying thing that is an obligation is the credit, it is the buying and selling of government debt. But the dollar that you have in your pocket, and any of us old enough to remember the 1970s knows this, is only as valuable as American monetary policy. I remember in 1980 when interest rates were 13 percent and it cost 21 percent to take out a mortgage. Your dollar wasn't very valuable then and nobody guaranteed its value.

Mr. LOUDERMILK. Okay. I appreciate the clarification of that. In fact, recently I was at a restaurant and the waitress had just taken cash, and she handed me a bill, and she said can you tell me if this is legal? It was a silver certificate. I said, I'll tell you what, I will give you a bill of equal value, and I will take it.

So, I do want to follow up on the questions of Mr. Williams regarding Fintech and True Lender. Bank partnerships have continued to grow and the question of which entity is the True Lender is the subject of numerous court cases. And it has been resolved on a case-by-case basis in a lot of instances. Some courts have developed complicated multi-factor tests to determine who is the True Lender, but that causes significant confusion and uncertainty in lending markets.

So, Mr. Brooks, could you discuss why the OCC's True Lender Rule is important to give clarity and certainty to the lending markets?

Mr. BROOKS. Congressman, it is a great question, and it is all about how important you think clarity is. The philosophy I have, which I articulated at the OCC many times, was to quote Justice Brandeis' famous statement when he said, "Sometimes, it is more important that a question be settled than it be settled right." And so, my belief is that lending contracts, in a big global economy like the American economy, need a rule.

You could pick a different rule, but our point was to say someone needs to be responsible, there needs to be a clear bright-line test when a consumer takes out a loan as to whom he or she is taking the loan out from. And our belief was, we will have a two-sentence rule. The bank is the lender if its name is on the note, or the bank is the lender if it has funded the note on the date of origination, period, and we will take enforcement action against any bank who is the True Lender who violates the law. It's hard to see how that is not a good thing.

Mr. LOUDERMILK. Right. And some on the other side, as you have heard over and over again today, have alluded that the True Lender Rule will allow predatory lenders to engage in rent-a-charter schemes, and that is a concern of even some State-level bank examiners or directors. Can you explain how that rule does not allow for that?

Mr. BROOKS. The first thing is, we need to sort of take the adjectives and adverbs out of this discussion and start defining some terms. So when people call a loan a, "predatory loan," the question is, what do they mean by that? And what they generally mean is it was a loan that was originated at an interest rate that exceeds the borrower's home State's usury cap.

So if that is what you mean by predatory lending, Congress and the Supreme Court, between 1978 and 1980, made it clear that banks, both national banks and State banks, have the ability to export their home State's interest rate to other States. And why was that important as a policy matter? Because again, in the late 1970s, the market rate of money was in the high double digits and the State usury cap in some States was in the single digits, meaning that if you lived in that State and you didn't have interest rate exportation, you literally couldn't borrow money. That is not a good thing in the market cycle, right?

And I think the argument is when Congress decided that banks can export their interest rate, they decreed that was not predatory lending. So the question is, why does it become predatory lending when a loan that was legal when made is sold to somebody else?

The analogy I give is, if you are renting an apartment and you have a lease that says you have to pay $500 a month, and then the building owner sells it to a different owner and your lease is still $500 a month, what has changed? Did that rent suddenly become unaffordable? Did it suddenly become usurious? No. You live in the same apartment and you contracted to pay that amount. And in the 1970s and 1980s, we all recognized it was a good thing.

In my testimony, I talk about what a bipartisan consensus that was to allow rate exportation. All True Lender does is make those markets work better, provide clarity, reduce litigation, and make credit more available. Remember, in the 2 States that [inaudible] rule for 5 years, credit to low- and moderate-income people fell by 64 percent. That can't be what we want.

Mr. LOUDERMILK. Access to credit is really what the issue is, especially in a recovering economy when people are trying to get back into the workforce or become an entrepreneur and start a new business. And as you know, bank-Fintech partnerships have resulted in tremendous expansion of the availability of credit, not just for those who have good credit, but also for those with a limited credit history. Can you explain why adding more uncertainty in the lending markets will reduce access to credit for consumers and businesses?

Mr. BROOKS. I would ask the chairman—

Chairman PERLMUTTER. The gentleman's question—look, I gave 30 seconds last time, so you have another 30 seconds. Sorry.

Mr. BROOKS. Thank you, Mr. Chairman.

I would just quickly say that if a bank can't engage in Fintech and other partnerships to sell loans in the secondary market, the bank's ability to provide credit is limited by the size of its own balance sheet, because it can't sell that loan and then use the proceeds to make the next loan. When a bank is limited by the size of its own balance sheet, not surprisingly, it is going to focus on the safest and most profitable loans, which means loans to the richest people and the people with the best credit scores. So, the first people who get hurt when credit starts getting rationed are poor people.

Again, the Federal Reserve has done multiple studies showing that more credit equals less poverty, and my philosophy is that making credit markets work for everybody ought to be our highest priority.

Mr. LOUDERMILK. Well said.

And I yield back the remaining time I no longer have.

Chairman PERLMUTTER. The gentleman's time has expired, and if we get a chance, maybe we will do a lightning round for everybody after this. But we are basically dealing with the whole banking system and a number of different issues related to it.

I now recognize the gentleman from Illinois, Dr. Foster, for 5 minutes.

Mr. FOSTER. I would like to ask a couple of questions about what is going on in Wyoming, which seems to be a State that has more Senators than they have actual people. But in 2019, the State of Wyoming enacted a series of laws related to cryptocurrency, including one authorizing the charter of special purpose depository institutions (SPDIs). And in September, Wyoming approved the first SPDI application for Kraken Bank, which is a digital asset company based in Cheyenne. The bank plans to offer services such as digital asset custody, demand deposit accounts, and wire transfer services, and, at this time, it seems that Kraken is not seeking deposit insurance from the FDIC. Instead, the bank has promised that it will maintain 100 reserves of deposits in fiat currency and in liquid assets.

Now, the rules of the Wyoming Banking Division define liquid assets to include investment-grade corporate debt, investment-grade U.S. State and municipal securities, and other investment-grade Federal or State Government agency securities. So, under stressful events, some of these instruments would make that arrangement inherently unstable, such as when you have an interest rate swing and Treasury bond prices would fall, or corporate credit risk might increase, causing capital losses.

Ms. Johnson, do you have concerns that this model of capitalization may not be robust enough to withstand periods of economic stress?

Ms. JOHNSON. Thank you so much, Representative, for the question. I do have strong concerns, and I would like to sort of situate this conversation in reference to the 2008 financial crisis. At the moment, it may not be the case that Kraken is soliciting Federal deposit insurance, however, should Kraken or other—as was referenced earlier with Coinbase—cryptocurrency exchanges or platforms operating in this space, and experience significant solvency crises, we should not assume that they would not be eligible for some type of relief.

I would point in this moment to the Fed's discount window being made available to AIG, and in the moment that the Fed's discount window was being made available to AIG, to an earlier point in conversation, I was leaving a position as associate general counsel at JPMorgan Chase. It was within weeks of us acquiring another bank, now defunct, but which had a long history, Bear Stearns. And I would like to just underscore that there is more than sufficient evidence in the cryptocurrency space already that exchanges not only experience solvency crises, but they are subject to cyberattacks that have left them unable to satisfy customer deposits. They have also been subject to any number of scams and misconduct, more broadly.

Mr. FOSTER. Thank you. And I would like to also talk a little bit about their capitalization. The Wyoming SPDI capital guidance states that a prospective SPDI should consider one-and-a-quarter to one-and-three-quarter percent of proposed asset under management or assets on, or assets under custody or $10 million, whichever is greater, as an appropriate minimum requirement for chartering. However, these requirements will be developed on a case-by-case basis. The banks, under supervision of a Federal banking agency, are required to maintain basic minimum capital requirements that translate to a percentage of assets. And furthermore, traditional banks have other key protections such as deposit insurance or access to a lender of last resort.

Professor Gerding, since the SPDIs do not have deposit insurance or a lender of last resort, would you consider SPDIs to be adequately capitalized under the Wyoming Banking Division's general formula?

Mr. GERDING. It is very difficult to say, Representative Foster, because of that critical phrase that you mentioned in your remarks: "a case-by-case basis." It is hard to know whether the way in which Wyoming regulators will actually look at applicants for these charters in a consistent way, and in a way that actually makes sure that they are well-capitalized. And I worry that a lot of these decisions are going to be made on a case-by-case basis and in a very non-transparent way.

Mr. FOSTER. Okay. That is actually a valuable thing to keep our eyes on, so I appreciate that.

Just a quick question, one big issue with crypto generally, Fintech generally, is the whole business of, Know Your Customer (KYC), and the ability for customers to basically prove who they are online. And there are proposals that are being made, and actually done in some States, that consumers will have access to so-called digital drivers' licenses to prove who they are online. Do you have any comments on how that may make the whole, Know-Your-Customer/Anti-Money Laundering (KYC/AML) situation improved no matter what charter you adopt?

Chairman PERLMUTTER. The gentleman's question will require a long time to answer, and I would ask that either we do it in the lightning round, or you submit it in writing, and the panelists can answer your question in writing for the record.

Mr. FOSTER. I appreciate that, Mr. Chairman. I yield back.

Chairman PERLMUTTER. The gentleman's time has expired. Thank you.

The gentleman from Tennessee, Mr. Kustoff, is recognized for 5 minutes.

Mr. KUSTOFF. Thank you, Mr. Chairman. Thank you for holding today's hearing, and I do want to thank the witnesses for appearing, as well.

Mr. Pacheco, if I can, to you, obviously, the last 12 to 13 months have created a lot of new normals, a lot of new habits. Can you talk about, from your customers' perspective, what you have seen in terms of changing of preference and maybe changing of habits accelerated by the pandemic?

Mr. PACHECO. Sure. Thank you for the question, Congressman. The last 12 to 14 months have been very disruptive. It has been disruptive for in-lobby transactions and traffic, and we have had to shift to other avenues and sources and solutions, and that includes things like mobile banking, online banking, desktop banking, certainly a higher utilization of telephone banking, and, in a last-resort perspective, utilizing drive-thru banking. So, it has been very disruptive.

And in each of those cases, we have used solutions that we have partnered with other companies on. Our mobile banking platform would be a great example. I think that some of the current things we are doing relative to technology innovation to be able to drive that, and then also including mobile deposits on that platform. And so, the partnerships that we have had have been a welcome benefit to our membership during the pandemic.

Mr. KUSTOFF. Thank you, Mr. Pacheco.

Mr. Brooks, I do want to echo other people who thanked you for your prior service to the government. I appreciate your opening statement. I also appreciate your written statement. Can you talk about, kind of following up on Mr. Pacheco, the change in the way customers now operate in this environment and what does it say about the future of the financial industry?

Mr. BROOKS. Congressman, that is a great question, and I appreciate Mr. Pacheco's comments as well. I think one of the reasons it is great to have a credit union representative on this panel is that it shows that in order to meet the credit needs of Americans, particularly in a post-pandemic sort of contactless environment, it is going to take all-hands-on-deck. So the answer clearly is not that the biggest banks alone can solve all of our credit problems. Indeed, Jamie Dimon just said in his annual investor letter last week that the role and relevance of banks in the economy is the smallest it has been at any time in the last number of decades, because customers preferences have changed.

I think Congressman Barr has it right, that there is a real urban-rural divide on this, but most people in the United States have elected not to visit bank branches. I'll just ask any of you, when was the last time you went into a branch for a significant transaction? And the pandemic has accelerated that kind of thing, so you have a combination of how many people want to do things from home, like we are doing this hearing today. Many people don't want to interact with other people that they don't know in day-to-day interactions, and a significant amount of capital has fled the banking system for other applications. This is why Fintech valuations are now higher than bank valuations on a revenue multiple basis over the last five-year period.

And so, in that world where capital has left banking and consumer preferences have shifted to other kinds of platforms, the policy question is, how do we make sure the system is still safe and sound, and consumer protections are respected? That is the question. There is no one answer. It is not going to be to keep all Fintechs out of banking; that is not going to be the answer. It is not going to be to say crypto must be banned because it is a source of terrorism financing now that it is a two-and-a-half trillion dollar market.

What it is going to be is an all-hands-on-deck attempt to make sure that we regulate similar activities similarly, regardless of whether that activity takes place on a legacy bank platform, a Fintech platform, a crypto platform, or whatever. If you are doing payments, you should be subject to payments regulation. If you are engaging in credit, you should be subject to the fair lending laws, and it shouldn't matter whether you are a legacy depository or something else. Consumer preferences change and the system you all regulate has to evolve with that.

Mr. KUSTOFF. Thank you. You mentioned Congressman Barr, and I want to follow up on his line of questioning and also the comments that you made in your written statement, at least about the de novo banks and the lack thereof over the last "X" number of years and the closure of bank branches.

In my district, I represent part of Memphis, but also a fairly rural part of Tennessee. I travel across the district quite a bit, and what I hear is that we have a lack of rural broadband. And as we talk about the continued emergence of Fintech, how do we mesh that together? How can the Fintechs fill the void of some of these closures, and yet our communities not have broadband?

Mr. BROOKS. Congressman that is the all-hands-on-deck point. We need a combination of, it needs to be easier to charter new banks and it needs to be easier for Fintechs to fill voids. We need all of that.

Mr. KUSTOFF. Thank you very much.

My time is up, and I yield back. Thank you very much.

Chairman PERLMUTTER. Thank you, Mr. Kustoff.

The gentleman from Florida, Mr. Lawson, is recognized for 5 minutes,

Mr. LAWSON. Thank you, Mr. Chairman. I would like to welcome everybody to the committee. There has been a very good discussion today. Now, I will probably, if I have time, go back to Mr. Brooks, and the reason why I said that is because I have a lot of students in my district, and they are much younger and they don't want to go in the banks. But some of the other citizens around my age still want to go in these branch banks and sit down and talk to somebody. I really need to get this message across, so I hope I can come back to you.

I noticed that Professor Gerding, in his earlier testimony, stated that he wrote in the separation between banking and commerce proposed risk for financial stability, and consumer protection are threatened to distort a financial market by allowing commercial firms that can obtain banking power and privilege to compete unfairly with the firms that cannot. And secondly, distort banking markets by allowing non-banks to offer banking services without facing the same degree of supervision and regulation as banks which, in turn, would create incentives for banks to take more risks, lobby for deregulation. Can you please explain those three points for me, sir?

Mr. GERDING. Thank you. Let me explain the last piece first. When you undermine the bank charter, when you allow competitors to unfairly compete with banks without being subject to the same set of regulations, and you give all of the powers and privileges of a bank to a non-bank, that has an effect on bank behavior as well. And it is just core banking economics. When you undermine the bank charter and allow unfair competition, banks are going to respond by taking more risk, and that is partially what we have seen in the last 20 years, and a big part of what we saw in the global financial crisis. So, that is the effect on the banking sector.

The commercial sector, by allowing non-banks to get powers and privileges of banks including exemptions from a whole host of State laws, which Mr. Brooks has not really mentioned, you are allowing the firms that have charters to basically undercut their rivals in commercial markets. And by allowing commercial firms and non-banks to have access to things like Federal Reserve emergency loans and the Federal Reserve payment systems without being subject to the same set of regulations and the same duties of banks and functions of banks, you are basically distorting commercial markets, non-banking markets.

Mr. LAWSON. That is incredible.

Mr. Brooks, before my time runs out, you talk about the change in marketing the way individuals like to do banking and really don't, sir—where, when people aged 50 to 60 and above, I don't know whether you address those groups, but maybe they are coming along as much as the younger people, because I noticed in a lot of where we have a lot of students and stuff in my area, maybe 50,000 or 60,000 of them, it is a whole different story in terms of how they go into banks in the future. And so, I don't know whether you have time to comment on that, and looking at the trends, but I better stop right now before my time runs out and give you a chance to respond.

Mr. BROOKS. Absolutely. Congressman Lawson, I really appreciate the question. I would make a couple of comments. First of all, there are clearly generational changes and preferences. I am the youngest person I know who still writes checks. Nobody does that anymore. My kids aren't aware of what a check is. So, there is a little bit of that where people just like doing things on their phones.

But there is also something that is more fundamental going on here, which is that banks, as part of a business model division, have retreated from areas that they used to serve better than they do today. So, for example, more consumer lending happens outside of banks than inside of banks. That would have been shocking 25 years ago, but today the percentage of consumer funds being delivered is being done on Fintech and other non-bank platforms not supervised by the OCC or any other Federal regulator.

So, why is that? It is because the cost involved in a big bank underwriting somebody for a $5,000 personal loan to replace their hot water heater isn't worth the input cost, and so they have abandoned that. And what I find interesting about the discussion is they seem to believe the legacy banks are somehow the only legitimate source of financing, and yet the market tells us otherwise. They are not serving the needs of sort of average Americans the way that they used to, and so Fintechs and others have come in to fill the gap.

My belief is that activity ought to be supervised. It ought to be safe and sound the way that other things are, and we shouldn't fetishize what the word, "bank," has historically conjured up. It is not what the statute says. It is not the way it has always been, and [inaudible] in the market.

Mr. LAWSON. I yield back, Mr. Chairman.

Chairman PERLMUTTER. Thank you, Mr. Lawson.

Now, we will go to Mr. Rose from Tennessee for 5 minutes.

Mr. ROSE. Good morning, and thank you, Chairman Perlmutter and Ranking Member Luetkemeyer, for holding this hearing today.

Mr. Brooks, welcome back to the committee, and thank you to all of our witnesses for being here with us today. As we discuss financial institution charters, I think it is important that we avoid revisiting outdated regulations and instead look to the future. Technology and innovation have increased access to financial services for many Americans, and it is important that we provide clear rules of the road to allow for continued growth in this space. A large portion of my district in middle Tennessee is rural. In addition to having to travel farther distances to obtain banking services, rural communities have seen increased costs in accessing financial services, in part due to branch closures.

As of the third quarter of 2020, there were 13,000 fewer banks in rural communities than in the 1980s, and although our community banks are doing their absolute best to serve our communities, rural areas continue to face the long-term effects of these closings. Mr. Brooks, could you discuss how Fintechs could step in to try and fill those gaps in rural communities?

Mr. BROOKS. Yes, absolutely. Congressman, first of all, I will just say, and no offense to the chairman, that although I am from Colorado, I did spend my first 5 years living just outside of Paris, Tennessee. So these issues actually sort of resonate with me in a personal way. And I would also say that Fintech is not the solution for every problem under the sun, but it is a solution as part of an all-hands-on-deck approach.

The thing about Fintechs is that Fintechs are able to bring capital sources that are outside of your community into your community. And historically, the way that a rural area would be served is you would have a local community bank that would have a couple of branches, its deposits would all have been sourced from the local community, and then those deposits would be reinvested into loans to borrowers, whether they were agricultural loans to farmers or small-business loans to the mom-and-pop cafe on Main Street.

The problem with that is, as America has disinvested from rural communities over the last 30 years on kind of a long-term basis, that kind of capital, even if you had a bank branch, is probably not sufficient to serve the credit needs of places like your district. So, one of the advantages that Fintech offers, and I would argue actually over the long term one of the advantages that crypto offers, is that it unlocks sources of capital that are far, far away from your communities, and it is able to deliver them over the internet to any creditworthy person who happens to live in middle Tennessee. I guess, my main point is that there may not be enough capital there to justify a de novo bank, and yet, there may be creditworthy people who need to access capital sourced elsewhere.

Mr. ROSE. During your time at the OCC, you focused on increasing access to charters for Fintechs. Could you describe the barriers to entry for new firms looking to get into payments or lending?

Mr. BROOKS. Yes. If you put aside the bank charter, and you wanted to start a payments company—let's say you wanted to start Stripe today. The first thing you have to do is you have to go and obtain 50 money transmitter licenses in all 50 States, and that takes a lot of time, and it is incredibly expensive. The legal compliance costs that are different from State to State become very difficult because some States mandate things that are literally prohibited in another State. And so, finding a way to do that is extremely difficult.

Generally speaking, and I guess I do want to speak for a moment to the State law preemption point that was raised a moment ago just so that I can say that I spoke to it. Back in the early days of the Republic, when there was a debate about whether the Federal Government should assume the State's revolutionary war debts or whether we should have the First Bank of the United States, we had this discussion, and the reason that Alexander Hamilton won that debate as opposed to the Jeffersonians is because of a belief that if we are going to have a big economy, big enough to compete with the powers of Europe, or in these days, the powers of Asia, we don't have the luxury of suffocating our businesses, our big businesses anyway, with different State-by-State regulations.

That is why in the 1970s, Congress enacted rate exportation, because of a belief that you don't want Illinois to be able to kill commerce because it—and I am just making up Illinois—has a different view of interest rates or banking charters or anything else compared to Indiana, right? That doesn't make sense. We are a big, unified nation and as companies grow and operate on an interState basis, the idea of getting 50 State charters to operate your payment company doesn't really make a ton of sense. I don't think Hamilton would think it made a ton of sense.

Mr. ROSE. In the few moments that I have left, if you will, I will ask this question. In your testimony, you emphasized how there has been a lack of new bank charters in 10 years. Can you explain the benefits of increasing the number of charters, whether for traditional or online banks?

Mr. BROOKS. Sure. Most Americans still feel most comfortable opening up their account in a bank branch. There are certain transactions for which they need to talk to a banker. It is not fair to see how we have lost the [inaudible].

Mr. ROSE. Thank you.

Mr. Chairman, I yield back.

Chairman PERLMUTTER. Thank you very much.

We will now go to the gentleman from Illinois, Mr. Casten, for 5 minutes, so he can defend his State.

[laughter]

Mr. CASTEN. Thank you, Mr. Chairman. This has really been a great hearing. I think you undersold it when you said we are trying to learn about the whole banking industry. We are also trying to learn about monetary theory. It is hard to do all this in 5 minutes.

I want to just start with sort of two statements that I think we all agree with on this panel. Number one, there has been a tremendous amount of good and necessary and entrepreneurial innovation in the Fintech space, which is fantastic, so let's make sure we don't squelch that. Number two, there isn't a company in the world that comes before us and says, I would like to have more regulation.

And I mention that because particularly with some of the emerging Fintech players, we hear all the time, when they come before us, what they are not. "I am not an ETF." "I am not a bank." "I am not a credit rating agency." "I am not a credit card company." We very rarely hear them say what they are, because for them to say what they are would be for them to implicitly say, "Therefore, I would like to be regulated under the following structure." And I think the value of this hearing is getting some clarity on what they actually are.

Ms. Johnson, I have two kind of big questions for you, and I preface that by saying I am probably going to cut you off before you finish the first one, and I apologize in advance for that. But in your remarks, you said that the OCC and the FDIC created steps to allow firms to engage in banking activities while being subject to less regulation and supervision, and that the OCC lacks the authority to charter non-depository national banks.

Now, if we think just about sort of the distinction between those Fintech firms that are doing one small thing as Mr. Brooks mentioned, maybe a payment processing firm, and those in the Big Tech space that are doing this whole array of consumer credit, financial transaction services, setting aside the current legal authority, who do you think should regulate those, and how would you think about that and in a minute or so, so I can get to my next question?

Ms. JOHNSON. Representative Casten, I think that is a great question. I think the first point is the one you made. What exactly is being regulated? I think we must pin the firms down, and at the very least, require them to describe the regulatory regime they believe they should be subject to based on their activities. Otherwise, they engage in regulatory arbitrage, which is the purpose of this hearing. You can evade tax. You can invade securities law if you arbitrage your activities in a manner that avoids the application of regulation to your point.

Mr. CASTEN. Thank you, and if you have more thoughts, I would love to follow up with you, because that is sort at the core of all of these conversations.

The second question gets into, and I said at the start that we are having conversations that are really almost about monetary theory right now. I think there is a lot of the underlying logic for what Bitcoin is; they are old hard-money, gold-bug kind of arguments and we don't need to get into all that right now. But we have a financial regulatory structure that is designed to ensure that there is sufficient liquidity in the market and in your bank so that when you go to withdraw something, the cash is there. If you deposit tulip bulbs in your bank, the bank doesn't loan out 80 of your tulip bulbs, they make sure it is all there, in a safe deposit box.

But as we have had things like this recent situation in this bank in Anchorage that is essentially a crypto company, how should we be thinking about what the role of the regulator is to ensure that holding increasingly volatile assets on a balance sheet doesn't compromise the liquidity of the system, particularly as the volume of those assets grows?

Ms. JOHNSON. Representative, I think this is a great question, and I think we only have to look at the movement in the price of Bitcoin from the moment that COVID-19 was declared a global pandemic to today and watch the movement and the value of that single asset in an asset class to identify an example of the problem you just described. If we are allowing banks to hold and count or calculate reserves based on this asset class, I think we really have to fundamentally revisit, interrogate, and clearly understand how we set those valuations and the rules and regulations that apply to this new asset class. I say that as a student, as a teacher, and as a former practitioner engaged in the development of credit derivatives, which—credit default swaps specifically were at the heart of the most recent financial crisis. And part and parcel of the problem there was a misunderstanding, a fundamental misunderstanding of the potential liability that this new class of assets could create.

Mr. CASTEN. Thank you. And I would love to follow up on that as well.

Mr. Carrillo, with the few seconds I have left here, did you have any follow-up thoughts on that?

Mr. CARRILLO. Yes. I would just like to note that this is all an environment for volatility and instability, as Professor Johnson said. We keep hearing about going back to the good old days of the 1980s, but that is when banking was especially wild to me and it hurt marginalized communities specifically.

Mr. CASTEN. Thank you.

And I yield back.

Chairman PERLMUTTER. The gentleman's time has expired. Mr. Budd from North Carolina is recognized for 5 minutes.

Mr. BUDD. I thank the Chair.

Mr. Brooks, today we are seeing a lot of innovative products in the form of digital assets, decentralized finance, which could be revolutionary for the banking system. We had Coinbase's direct listing yesterday, so it is obvious that this technology isn't going away and we are now at the crossroads of embracing this technology or falling behind other countries. One of my great concerns is that we get surpassed by other countries that are more willing to engage on this.

So, Mr. Brooks, my question is, do you see a world where we can have an intersection of legacy banking, what we know of as banking, and also DeFi by allowing banks to use blockchain protocols and use that to eliminate inefficiencies and offer better products and services to consumers?

Mr. BROOKS. Congressman, thank you for the question, and also thank you for all of your engagement during my time at the OCC. I have always loved these conversations, and I have learned a lot from them.

Let me start with the legacy bank part of things. One of the reasons that the OCC started focusing on crypto-regulatory issues is because of the fact that two or three of the largest banks in the United States were already exposed to various crypto activities to the tune of billions of dollars.

For example, at the time that I walked into the OCC, JPMorgan had deposits exceeding a billion dollars backing a stablecoin project, but there was no Federal guidance on how stablecoins ought to be thought about. State Street was doing likewise for another stablecoin project, and there were smaller banks, Silvergate and Cross River and some others, that were providing other kinds of support services for crypto assets.

So, it is very clear that there is a lot of interest from traditional companies in crypto. And you see that from the fact that Intercontinental Exchange has started its own crypto exchange, that Goldman Sachs is now restarting their crypto desk, and that Fidelity has created a digital asset custodian. And Anchorage, another bank that, by the way, doesn't have these assets on their balance sheet, they are a custody bank that holds those assets for third parties, that is a fee-for-service business, not an asset-heavy business. But the point of all of those things is to say that banks have traditionally provided the role of safeguarding and safekeeping their clients assets and crypto is another asset that has come along in the last 10 years and has now achieved scale. So, clearly, the legacy institutions have a role to play.

In terms of technologies like DeFi and payments in the form of stablecoins and other kinds of things, these are the kinds of technologies that bring internet technology to finance the way that the original internet brought those decentralization benefits to information sharing first and to regular commerce second.

I think one of the biggest misunderstandings about crypto, which I think is really important to understand, is that we are building a second internet here. The whole point of crypto tokens having value is to induce people to provide computing power to maintain a decentralized network that otherwise would be maintained by Google and Facebook. And the way to induce regular people to connect computers to maintain those ledgers is to let them take a native token that has value on it, so that is why we have a decentralized ledger. It is not built for terrorism financing; it is built to allow us to have a truly decentralized internet. That is what it is all about.

And so, if you believe that American soft power in the world has a lot to do with the fact that we control the Internet Corporation for Assigned Names and Numbers (ICANN) and the internet protocol, I would think you would feel similarly about the use of these internet protocols in in financial services. DeFi is one example of where having open source software that is allocating credit versus having a credit officer sitting in an office—these are ways of making sure that there is not some renegade employee who is discriminating or taking risks because the algorithm is visible for everybody to see and can be changed by other people on the network. To me, that is a more optimistic view of the future than a future that holds onto the idea of individual bank credit officers allocating capital in our society.

Mr. BUDD. You are giving some examples of promoting very forward-thinking structures and policies rather than revisiting outdated regulations, which I don't think benefits consumers. But in order to maintain the supremacy of U.S. financial markets, we have to work on modernizing charters and finding ways to increase competition innovation. Many modern financial services providers and Fintech companies today face the choice of either relying on regulated partners or seeking existing charter options that limit technology development.

You have other governments like Singapore, the U.K., and the EU which provide modernized regulatory options on top of traditional banking charters, which allows for more innovation. So, what are some of the ways that that we can navigate this system and promote innovation?

Mr. BROOKS. That is a great question. One obvious example is to ask the question, why in the United States do we only allow banks, but not other financial systems or companies, to access the payment system? In the U.K., and in other places that have open banking and e-money licenses, any payment company can access the payment rails. In the U.S., though, we fetishize and protect incumbent banks. That is a complete disadvantage.

Mr. BUDD. Thank you, and I yield back.

Chairman PERLMUTTER. Thank you, Mr. Budd, and I would just remind everybody that 10, 12 years ago, everybody was relying on our Federal Reserve and our banking system to help kind of correct the global banking system.

Mr. Torres, who is the newest member of our committee, was looking forward to this primer on the banking system and currency, and I don't think he has been disappointed. I now yield to the gentleman from New York, Mr. Torres, for 5 minutes.

Mr. TORRES. Thank you, Mr. Chairman. It has certainly been a primer. I am new to these issues. Obviously, one of the issues before us is the separation of banking and commerce. Blurring the line between banking and commerce, as ILCs do, raises concerns about systemic risk, moral hazard, and market concentration. And my question is, have we seen any or all of these concerns borne out by the experience of other countries that allow for the intermingling of banking and commerce? What lessons can we learned from the experience of those countries? And anyone who knows the answer can feel free to answer, to weigh in.

Mr. CARRILLO. I am happy to speak to that issue, Congressman Torres. I would say that a good example of the sort of thing of the dangerous conglomeration that can occur when we have loopholes in the broader depository infrastructure, or allow things to exist like stablecoins that act like deposits but are not regulated like deposits, is to be found in China, where the company Tencent has been brought further into the system, but in a particular way that is not particularly good for users or the people of China, especially when it comes to privacy and surveillance.

Of course, this is generally touted as being efficient, but intermingling, in Tencent's case, the social media platform with banking has led to, again, an unprecedented amount of power that we have perhaps not seen in human history because of the way the data collection and surveillance works now. Wedding that further to our monetary infrastructure here does not bode well. Thanks.

Mr. GERDING. I could add to that, Representative Torres, that in banking in both Japan and South Korea, there is an intermingling of banking and commerce. The problem there in both of those countries is that that intermingling has served to entrench financial and business conglomerates in both of those countries. So if we want our economies to have that high degree of concentration that we have in Korea and Japan, then we would need to start to think about eroding the wall between commerce and banking.

Ms. JOHNSON. I would just add to that, Representative Torres, if I may, that we should also be really mindful, specifically not just about the theoretical issues here, but the practical prudential regulatory oversight that Professor Gerding raised earlier.

I also think is it imperative to think about who is participating in which actions. This committee, and all of Congress, in fact, has been thoughtful about the implications of certain large technology firms and their continued consolidation and growth in the industry. I would like to underscore a point that my colleague on the panel, Mr. Carrillo, pointed out, which is not solely a matter of the prudential regulation that we were talking about in the moment, the separation of commerce and banking, but also the specific consumer protection concerns that will impact citizens in every one of your districts without fail and without exclusion.

Rural, urban, big city, small town, all across the nation, these companies monetize and commodify data about citizens, and we are now thinking about giving them access to data regarding the financial transactions of all citizens. And this is in a moment when we are unsure about what exact data protections exist for consumer financial data. This is an impending and continuing conversation, and I don't want to take all of your time. I just want to underscore that consumer financial data protection, alongside the broader prudential regulatory issues, I believe, should be important to everyone without respect to partisanship.

Mr. TORRES. I know that much of the regulation of these bank-like entities happens at the State level, but a case could be made that as a general rule, it is much better to have uniformity in the law than to have a cacophony of widely varied State laws. So it seems sensible to have a Federal framework for regulating Fintechs and cryptocurrencies and blockchain. What is the argument against uniformity of the law?

Mr. GERDING. I could address that, if you would like.

Mr. TORRES. Sure.

Mr. GERDING. I think there is an interest in uniformity, and Mr. Brooks mentioned money transmission statutes. It is difficult for payment systems or payment companies to comply with 50 different payment statutes in 50 different States. The better way to do that is to have Congress act to create or promote uniformity in statutes, not to have the OCC do that in a backdoor manner and basically preempt State laws with a four-page policy document that created a radical Fintech charter.

Mr. TORRES. Well, the District Court agrees with you. Thank you.

Chairman PERLMUTTER. The gentleman's time has expired.

The gentleman from Minnesota, Mr. Emmer, is now recognized for 5 minutes.

Mr. EMMER. Thank you, Chairman Perlmutter, and Ranking Member Luetkemeyer. I appreciate that you are hosting what is a very important hearing in which we have been able to examine our unique dual banking system through a nonpartisan [inaudible].

As financial innovation advances, it is important that we work to provide appropriate and considerate regulatory avenues for Fintech companies and financial institutions to best serve their customers. As we know, access to financial services greatly impacts the American consumer in terms of financial literacy, fair prices for financial services, and convenience. Competitive Fintech companies that offer these affordable services to anyone with a cell phone should not be held back from deploying their services to any and every American, which is why I appreciate the testimony we have heard today. In support as policymakers, we must keep this focus at the forefront of our attention. It is my hope that the FinTech Task Force will be renewed for the 117th Congress, and I look forward to carrying out these policy issues further on that task force.

With that, Mr. Brooks, it is great to see you again. Thank you for all of your work over the past couple of years at the OCC, as the Comptroller of the Currency. You demonstrated a strong commitment to creating a regulatory environment that encourages innovation and growth in this Fintech space and you have been a leader in providing the industry with the clarity that is so necessary to make sure they can innovate confidently.

Mr. Brooks, during your tenure at the OCC, the agency issued interpretive letters clarifying that national banks could offer services such as custody for digital assets that they historically offer for traditional assets, and that national banks could participate in independent node-verification networks to facilitate payments. Why do you believe these issues require clarification, and what impact do you believe these new technologies will have on the banking system?

Mr. BROOKS. Congressman, first of all, your partnership and guidance on these issues dating back long before I came to the OCC has been one of the joys of my life. I really appreciate all of the dialogue that we have had over the years about all of these issues. I would answer in two basic ways. First of all, it became clear a year ago, a year and a half ago, that crypto assets had grown to a scale that bank customers—I hear there is some background noise, so maybe we could mute our phones just so you can all hear me.

Chairman PERLMUTTER. Somebody, I think Mr. Emmer, maybe, you need to mute.

Mr. EMMER. Okay.

Mr. BROOKS. Great. So the point is that crypto is now a two-plus trillion dollar asset class, and the customers who own crypto assets are the same people who are also depositors and checking account customers and mortgage borrowers, et cetera, of banks. And so, it was no longer possible for us to ignore the fact that the assets that were growing in size and scale on the crypto side were lacking a safe place to be custodied or a safe place to be exchanged for value the way that all other assets can transact on a bank. So, the first reason that we launched down the path was the recognition that the market had grown and that banks traditionally provide a safe custody location and safe transaction rails for people engaged in those things.

But as we thought more deeply about that over time, what also became clear, and this comes back to my point about how we sort of tend to fetishize legacy banks over other people who are performing the same services in a different way—it became clear at a certain point that one of the things that blockchains are, is they are payment networks. They are a set of technologies for transmitting value from person A to person B.

As I said, in the United States, unlike in our global competitor countries, we only allow banks, as defined, to connect to the government payment system at the Federal Reserve or to connect to the automated clearinghouse, which is essentially the bank cartel that runs its own payment system. We don't allow other companies.

And at the OCC, our basic view was, well, wait a minute. There is nothing magic about Fedwire. There is nothing magic about ACH. The point is, banks have a statutory power to process payments. That is the paying checks power in 12 U.S.C. §24.

And so if a new technology has arisen, which is an open blockchain platform for transmitting payments, there is no reason banks shouldn't be allowed to take advantage of the faster, more secure, and more certain environment of blockchain if they can also connect to Fedwire or SWIFT or ACH. That is the point of what innovation is always about.

And by the way, the OCC has always used interpretive letters to clarify the way that existing bank powers can be conducted on new technology platforms. Think back to the 1960s, when the Comptroller at the time issued an interpretive letter which said that banks can engage in data processing. No one thought Congress had to act at that time, but the point is that computers had been invented, and now a new internet of finance called blockchain has been invented, and the OCC will always lead and help bank technology.

Mr. EMMER. Thank you. My time has expired. Thank you, Mr. Chairman.

Chairman PERLMUTTER. Thank you, Mr. Emmer.

The gentleman from Illinois, Mr. Garcia, is recognized for 5 minutes.

Mr. GARCIA OF ILLINOIS. Thank you, Chairman Perlmutter, and Ranking Member Luetkemeyer, for convening this hearing. And thanks to all of our witnesses today for shedding light on a complicated, but important topic.

I represent a working-class, largely immigrant district, and my district in Illinois needs the same things as any other district. We need investment in our neighborhoods and institutions. We need opportunities for growth, and all too often, these things are out of reach for communities like mine. Unfortunately, that is not new.

But every time a company wants to get out of regulations, they say that they are going to change, they say that they are going to help if they can just sell a certain type of product or market in a certain way. That is not new either.

What I am worried about is that the business model of many companies we are discussing today is either take advantage of consumers or take advantage of regulated competitors. Since my colleagues mentioned the True Lender Rule, I want to clarify that I introduced the resolution to repeal the rule for that very reason. The Rule undermines the ability of States like mine and more than a dozen others to protect consumers from predatory lending, but I turned back.

Mr. Gerding, let's say a retail company like Walmart or Amazon offered financial services through an ILC. All of a sudden, they know a lot about you. They know how much money you have or whether you can pay your credit card bill. They know what you buy. So, should consumers worry about this kind of blending of commercial and financial companies, and would these companies have a competitive advantage over other businesses that don't have this kind of data about their customers?

Mr. GERDING. Absolutely. Representative Garcia, they should be worried. One of the things that the other panelists have mentioned earlier is that you have to worry not only about financial stability, but data privacy. And a lot of the Big Tech and Big Retail companies already have enormous amounts of information about consumers. Being able to combine that with payment services, banking services, and financial information about customers would exacerbate those problems.

I should note that there is one way of dealing with that. The Gramm-Leach-Bliley Act, one of the bright spots of that Act was introducing privacy regulation. But privacy rules under Gramm-Leach-Bliley only apply to financial institutions. So if large conglomerates are going to be entering into the banking space and being given bank charters, I think we need to start thinking about expanding and applying the Gramm-Leach-Bliley privacy provisions to a whole host of larger institutions and larger conglomerates.

Mr. GARCIA OF ILLINOIS. Thank you, sir.

Mr. Carrillo, in your testimony you discussed how companies and laws that claim to expand financial access for underserved communities can end up preying on those communities. Can you tell us about the risks of allowing new Fintech companies to offer unregulated services, and how can Congress promote economic inclusion without leaving our constituents vulnerable to exploitation?

Mr. CARRILLO. Thank you very much, Representative Garcia. I want to zoom out and say that to your point in this war between the neo-Hamiltonians and the neo-Jeffersonians was lost as the actual people who currently use the U.S. financial system. And people do not need to be included. If they are included in a predatory structure, they do not need to be given access to credit if what they are given access to is something that actually hurts. The way that, for instance, the former Acting Comptroller talks about credit, you would think that it had no downside, and he still has not addressed the privacy issues nor have any of the Republican members of this panel, despite the fact that they go to our very constitutional protections, which should be important to everyone in this room. I would appreciate it if we did not look at this debate with one eye. Thank you.

Mr. GARCIA OF ILLINOIS. Thank you, sir.

Mr. Chairman, I yield back.

Ms. JOHNSON. Representative, may I just add one tiny line to what Professor Gerding just offered regarding privacy protections in the Gramm-Leach-Bliley Act? The Dodd-Frank Act also contains, in Section 1033, an opportunity area for this Congress to act and to protect consumer financial data. I really think that your commentary is accurate. The marginalized, hard-working, low-income or no-income, struggling middle-class families in many of the districts represented by the members of this committee would be most vulnerable if some of the conglomerates existing in Big Tech gain access to additional information. In fact, they will form surveillance capitalism and that will most affect Black and Brown individuals, just to be blunt and honest.

Mr. GARCIA OF ILLINOIS. Thank you for chiming in, Professor Johnson.

Thank you. I yield back, Mr. Chairman.

Chairman PERLMUTTER. Thank you, Mr. Garcia.

I think you are the last member to be here and to want to ask questions. We have gone on for 2½ hours now, so I want to bring this to a close. This has been very interesting, and to the ranking member's point, I think we are just really beginning to get some idea of this subject and the need for innovation, as Mr. Brooks has talked about, so that people who use the services and businesses don't skirt around the edges of the system where there is no regulation whatsoever, but also the detriments, whether it is privacy or some kind of abusive approaches that a company may take to an individual or to a business.

There is nothing new under the sun. It might happen faster or something might happen in a different way, but we need to make sure that we have prudential regulations that allow for businesses and individuals to transact things without being harmed. And so I think, Mr. Ranking Member, I am going to try to convince the committee that we have another couple of hearings on this subject.

And I would like to thank our panelists here. Your testimony, both your oral testimony and your written testimony, is outstanding. I wish Mr. Torres was here, because if you read all of those papers that you have all written, you will learn just about everything there is about the banking system from Hamilton and Jefferson to today.

Without objection, I would like to enter statements into the record from the following organizations: the American Bankers Association; the American Financial Services Association; the Bank Policy Institute; the Consumer Bankers Association; the Independent Community Bankers of America; and the National Association of Industrial Bankers.

I am surprised that nobody mentioned Glass-Steagall in the commerce and banking kind of context today, but obviously, as we came through the Depression, we wanted to make sure that we didn't mix commerce and banking. I want to thank all of the witnesses for their testimony and for sharing their time, their talent, and their expertise with this subcommittee. Your testimony today will help advance the work of our subcommittee and of the U.S. House of Representatives.

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.

Thank you all very much for your testimony. To the Coloradans, it was good to have you here, but to those of you not from Colorado, we are very happy that you participated as well. And with that, this hearing is adjourned.

[Whereupon, at 12:27 p.m., the hearing was adjourned.]

A P P E N D I X

April 15, 2021

STATEMENT OF

BRIAN P. BROOKS

FORMER ACTING COMPTROLLER OF THE CURRENCY

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER PROTECTION

of the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

April 15, 2021

Introduction

Chairwoman Waters, Ranking Member McHenry, Chairman Perlmutter, Ranking Member Luetkemeyer, and members of the Subcommittee, thank you for the opportunity to appear before you today to discuss bank charters, financial innovation, and the importance of a pathway for companies that provide financial services for millions of Americans to opt into a system of federal supervision that has ensured a safe and sound banking system for generations.

Framing this important topic requires that we first understand three facts.

First, the number of traditional banks in America – meaning insured depository institutions – has declined significantly over the past generation. In 2000, there were 8,315 insured commercial banks in the United States. By 2019, that number had shrunk to 4,519.[1] To be sure, much of that change reflected consolidation in the industry, but consumers also saw a reduction in access to traditional banks over the latter part of that period as the number of bank branches shrank from a peak of 83,000 to a little under 77,000.[2] The number of bank branches in low- and moderate-income (LMI) communities in particular fell significantly over this time period, with the largest banks closing thousands of LMI branches over a ten-year period.[3]

Second, the banking agencies all but halted new bank charters in the years following the financial crisis – a period when access to capital and credit was more important than ever. Between 1996 and 2007, between 100 and 250 new bank charters were granted every year save

---

1 https://banks.data.fdic.gov/explore/historical?displayFields=STNAME%2CTOTAL%2CBRANCHES%2CNew_Char&selectedEndDate=2020&selectedReport=CBS&selectedStartDate=1934&selectedStates=0&sortField=YEAR&sortOrder=desc

2 *Id.*

3 https://www.spglobal.com/marketintelligence/en/news-insights/trending/9j-uq-pfo45qidsxcfqqig2

for 2002, when 90 new charters were granted.[4] By contrast, in 2011, 2012, 2014, and 2016, ***zero*** new banks were chartered in the United States, and only one charter was granted per year in 2013 and 2015.[5] Only starting in 2017 did the pipeline for new charters open up, and then only modestly.

Third, as mega banks increased their market share and new entrants fell to near zero, customers in many financial services segments turned to financial technology firms (fintechs) and other nonbanks – either because the increasingly consolidated banking system was not serving them or because the products and services offered outside of the traditional system were more attractive. Neobanks that exist only online have the specific purpose of serving customers who either do not need, or do not live near, a traditional bank branch. Some, but not all of these, have sought banking charters and have explicitly made a business model of financial inclusion; one good example is Varo Bank, the first fintech ever to receive a bank charter, which I was proud to sign last year. On the lending side, consider the startling fact that fintechs today supply more personal loans than banks.[6] JP Morgan Chase CEO Jamie Dimon put it best in his annual shareholder letter released just last week. Under a headline stating that "Banks are playing an increasingly smaller role in the financial system," Mr. Dimon candidly observed that "U.S. banks … have become much smaller in size relative to multiple measures, ranging from shadow banks to fintech competitors and to markets in general."[7] This trend is likely to continue given that

---

4 https://banks.data.fdic.gov/explore/historical?displayFields=STNAME%2CTOTAL%2CBRANCHES%2CNew_Char&selectedEndDate=2020&selectedReport=CBS&selectedStartDate=1934&selectedStates=0&sortField=YEAR

5 *Id.*

6 https://internationalbanker.com/banking/how-unbundling-and-decentralization-are-reshaping-banking-and-financial-services/

7 https://reports.jpmorganchase.com/investor-relations/2020/ar-ceo-letters.htm

both customer preferences and investor pressure for the higher rates of return on fintechs[8] are driving lending, payments, and other traditional banking activities onto specialty platforms and out of the traditional system.

With these facts in mind, the country faces a set of important and complicated policy choices. Are we comfortable presiding over the historic shrinkage of the banking system, in which the biggest banks get bigger and more powerful and Americans in LMI communities both urban and rural have a hard time finding a traditional bank branch? If not, do we believe there is somehow significant capital waiting on the sidelines to invest in new brick-and-mortar insured depository institutions, and the political will on the part of the banking agencies to start chartering hundreds of new banks despite the trend of the past decade? If not, and Americans increasingly obtain their financial services from fintech startups and other nondepositories, are we really sure the system is better protected by keeping these companies outside the federal banking system – or might everyone be better served by allowing such companies to apply for and obtain a federal bank charter and thereby subject themselves to the rigor of bank supervision? That would certainly be one step toward leveling the regulatory playing field, something the bank trade associations claim to want.

The reality is that the current American financial system is an amalgam of banks and nonbanks. Innovation will improve the way traditional banks do business in certain areas while simultaneously continuing to drive certain other business lines out of traditional depositories. Thus any discussion of innovation and banking needs to consider (a) how innovation can make the traditional banking system stronger, more efficient, and more responsive to customer needs,

---

8 https://internationalbanker.com/banking/how-unbundling-and-decentralization-are-reshaping-banking-and-financial-services/

and (b) how the scope of the bank charter can adjust to accommodate the safe and sound delivery of traditional banking products and services by companies that are not chartered as banks today.

Innovation Within the Traditional Banking System

The Federal Banking Agencies Are (Slowly) Re-learning How to Charter New Banks

As noted above, in the years following the financial crisis the federal banking agencies largely lost the muscle memory for issuing bank charters. Complicating matters is the fact that many would-be new entrants into the banking system envision business models and technologies that differ from the traditional branch-based depositories of old. In order to accommodate these innovative new approaches, the OCC and the other banking agencies must develop new approaches for calculating capital requirements, assessing how well new risks can be managed, and implementing reasonable financial inclusion expectations. The good news is that this process has started.

Before delving into specific chartering challenges, it is first important to note that the OCC's historical process for chartering banks was time-consuming and complicated, often requiring multiple approvals from multiple internal committees (and sometimes even multiple approvals by the ***same*** committee) – a process that, when added to the FDIC's review for deposit insurance eligibility and the Federal Reserve's review for Fed membership, could take multiple years from initial consideration to charter approval. During my tenure as Acting Comptroller I set a goal of cutting the time from application to approval in half, and I am proud to say that the agency is on a path to hit that target based largely on a front-end reality check meeting with the Comptroller and the senior licensing team and a back-end elimination of duplicative committee reviews. Oversight by this subcommittee would help ensure that this directional progress continues.

I am also optimistic that the lessons learned from some of the recent licensing approvals will speed the chartering process in the future. For example, Varo Bank – the first true fintech to receive a national bank charter – took three years to navigate the three-agency process for approval. Grasshopper Bank, a venture bank using a novel technology platform, took more than a year and a half to get through the process. It is not likely that a process this lengthy will be able to satisfy Americans' demand for banking services in a world when the number of banks today is roughly half what it was 20 years ago, but unless new agency heads purposely slow down or limit new charters, agency staff now has a roadmap and a set of lessons learned that can be used to speed the process in the future.

Some of the most innovative new entrants have elected to acquire incumbent banks rather than seek de novo charters, as evidenced by completed or pending change-in-control applications from companies such as Lending Club, SoFi, and Jiko. Still others have learned that narrower bank charters with fewer required agency approvals – specifically the national trust bank charter – provide a simpler path to providing a defined set of financial services within a chartered bank environment.

These developments do not address perhaps the most crucial banking problem facing millions of Americans, however: In much of rural America,[9] and in many urban LMI areas,[10] there are simply no banks.[11] Residents of such areas thus either need to obtain their financial

---

9 Shaila Dewan, *A Small Town Loses a Pillar: Its Only Bank*, New York Times, March 28, 2009.

10 Nelson D. Schwartz, *Bank Closings Tilt Toward Poor Areas*, New York Times, Feb. 22, 2011.

11 *See* Testimony of Prof. Mehrsa Baradaran, https://www.congress.gov/116/meeting/house/109303/witnesses/HHRG-116-BA15-Wstate-BaradaranM-20190409-U2.pdf

services online, or from new banks, or from shadow banks in some form. Fintechs that operate online are useful for many things, but they do not operate with the same level of supervision and compliance oversight that a bank does – one reason why Comptrollers of both parties have advocated bank charters for fintechs since the Obama Administration. New brick-and-mortar depository banks are unlikely to be chartered at scale anytime soon unless the process and requirements for obtaining a charter are simplified significantly, as some on this panel have urged. Which leaves us with the shadow banking system – the payday lenders, title lenders, buy-here/pay-here establishments and the like. That alternative may be unattractive, but unless we are willing to make it easier for new companies to enter the banking system, it is the reality for many of our fellow citizens.

Valid When Made and True Lender: Increasing Credit Availability By Allowing Banks to Leverage Their Balance Sheets Through Fintech and Other Partnerships

The total demand for consumer credit in the United States far exceeds the amount of bank balance sheets dedicated to that business segment.[12] Moreover, state interest rate caps historically made it harder for residents of some states to access credit than residents of other states. Congress and the Supreme Court have addressed these problems in two ways. First, the Supreme Court's 1978 decision in *Marquette Nat'l Bank of Minneapolis v. First of Omaha Serv. Corp.*[13] and Congress's 1980 enactment of the Depository Institutions Deregulation and Monetary Control Act allowed both national and state banks to export their home state's interest rate to customers in other states. *Marquette* reached a bipartisan result – *Marquette* was successfully argued by Robert Bork, and Justice William Brennan authored the decision for a

12 https://www.federalreserve.gov/releases/g19/current/.
13 439 U.S. 299 (1978).

unanimous Court. And Congress's decision to expand the *Marquette* rule on interest rate exportation to state banks as well as national banks was similarly bipartisan, passing with an overwhelming majority of both Democrats and Republicans and signed into law by President Jimmy Carter. In short, in the inflation crisis of the late 1970s, when the prime rate peaked at 21.50 percent and some states had eight percent usury caps, American leaders of all political stripes understood the importance of preempting state interest rate caps in order to improve access to credit.

The second way Congress addressed the inadequacy of bank balance sheets to address all consumer loan demand is in empowering national banks to sell their loans to third parties. The National Bank Act provides that banks may enter into contracts, and the Supreme Court has held consistently for almost 200 years that banks' contracting powers specifically include the power to sell and assign their interest in loans to investors.[14] The implication for credit access is clear: When a bank sells a loan, it frees up balance sheet to make the next loan. This is true when a bank sells a consumer loan to a marketplace lender; when a bank sells a mortgage to one of the GSEs; or when a bank securitizes its credit card receivables. The principle is the same: Banks tap secondary market investors to sell loans and use the proceeds to make more loans. If we think access to credit is a good thing, it follows that letting banks make more loans rather than less is desirable.

This idea was called into question in the 2015 Second Circuit Court of Appeals decision in *Madden v. Midland Funding LLC*.[15] In marked contrast to the bipartisan consensus of the late 1970s surrounding interest rate exportation, some advocates cheered *Madden* for enforcing a state usury law and protecting consumers from high interest rates. But the reality of that

---

[14] *See Planters' Bank of Miss. v. Sharp*, 47 U.S. 301 (1848).

[15] 786 F.3d 246 (2d Cir. 2015).

"protection" was far murkier. Multiple studies of the effect of *Madden* on credit markets found that, when unable to sell higher interest rate loans to investors, banks focused their lending activities on smaller loans to wealthier and higher-credit-score consumers.[16] One study found that banks in the states subject to the *Madden* ruling reduced lending to LMI borrowers by an astounding 64 percent.[17] In short, the available evidence showed that enforcing a state usury limit against a bank-originated loan did not make credit less expensive for LMI borrowers; it made credit less available.

This is one reason the OCC (and separately the FDIC) adopted the "valid when made" rule in May 2020 – to increase access to credit by clarifying what had been established law until 2015, that banks can originate loans at a rate legal in their home state and may sell that loan in the secondary market without impairing the legality of the original loan terms. Of course, the rule was supported by other reasons as well, including the need for banks to manage the risks of their loan books in different economic environment and to manage concentration limits and other regulatory considerations.

The OCC understood, however, that some bank partnerships in the past had skirted the edges of consumer protection law through so-called "rent-a-charter" arrangements in which the involvement of a bank preempted state usury and other laws but neither the bank nor the bank partner accepted responsibility for consumer protection, anti-discrimination, and other legal requirements. That is why the OCC's true lender rule specifically addresses "rent-a-charter" practices and states that, in any case where a national bank either is named on the note or funds

---

16 *See* Colleen Honigsberg et al., *How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment*, 60 J.L. & Econ. 673, 675 (2017) (cited in *McShannock v. JP Morgan Chase Bank, N.A.*, No. 19-15899 (9th Cir. 2019)).

17 *See* Piotr Daniesewicz & Ilaf Elard, *The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy* 22 (2018), https://tinyurl.com/y5s3s7oh.

the loan on the date of origination, the OCC will hold the bank responsible for ensuring compliance with all applicable laws. In the words of the final rule, "[i]f a bank fails to satisfy its compliance obligations, the OCC will not hesitate to use its enforcement authority consistent with its longstanding policy and practice."[18]

In short, these two companion rules – "valid when made" and true lender – allow innovative fintechs and other companies to increase access to credit while ensuring that national banks subject to strict federal supervision are held accountable for consumer protection in the process. That, surely, is an advance over the previous status quo.

<u>Expanding Our Understanding of Bank Charters to Accommodate New Technologies and Business Models</u>

Economic Pressure to "Unbundle" Lending and Payments from Deposit-taking Is Driving a Significant Percentage of Traditional Banking Services Outside of Traditional Banks.

In a number of op-eds and speeches, I have detailed the reasons for the rise of fintech as a distinct category within the financial services market.[19] They are simple. ***First***, as in other areas of the economy, consumers have voted with their feet and migrated away from financial "supermarkets" and toward firms that specialize in particular financial products. SoFi's early success in the student loan refinance market, Affirm's point-of-sale financing product, or Square's success as a payments processor for small retailers are all examples. All such businesses involve activities that, in an earlier generation, would have been conducted inside of a bank. ***Second***, investment dollars are flowing into fintech because returns on a given activity

---

18 https://www.occ.gov/news-issuances/federal-register/2020/85fr68742.pdf

19 *E.g.*, Brian P. Brooks & Charles W. Calomiris, *Fintech Can Come Out of the Shadows*, Wall Street Journal, Sept. 9, 2020; Brian P. Brooks, *How Unbundling and Decentralization Are Reshaping Banking and Financial Services*, International Banker, December 3, 2020.

conducted on a specialty fintech platform are far higher than returns on the same activity when bundled with other activities inside a traditional depository institution. As I illustrated in a recent op-ed, investment returns in the fintech payments sector were 58 percent in the five-year period ending in Q3 2020, while returns in the Invesco KBW large bank ETF were up three percent in the same period.[20] That is why venture funding for North American-based fintechs has exceeded $20 billion in each of the past several years.[21]

The Rise of Decentralized Networks, Including Blockchains Powered by Cryptocurrencies, Is Likely to Transform the Way Economic Value Is Stored and Transferred.

The significance of cryptocurrency can scarcely be doubted if for no other reason than the market capitalization of all cryptocurrencies exceeds $2 trillion as of this writing.[22] Yet the project of cryptocurrency is not well understood by the lay public or by many policymakers and is often analyzed in reductionist discussions about whether Bitcoin "is backed by anything," whether a large or small amount of crypto transactions involve money laundering or other criminal conduct, or whether it is possible to have the benefits of blockchain technology without the need for cryptocurrencies.

In truth, the entire project of cryptocurrency is to eliminate middlemen in financial transactions. Historically, society needed middlemen to serve as neutral, trusted third parties in transactions between principals who neither knew nor trusted each other. The role of the middleman – i.e., the banker – was to allocate capital based on decisions as to who was a good credit risk to lend someone else's money to, to maintain ledgers of account as to who owed what

[20] https://internationalbanker.com/banking/how-unbundling-and-decentralization-are-reshaping-banking-and-financial-services/
[21] https://finledger.com/2020/12/18/2020-saw-a-record-number-of-fintech-mega-rounds/
[22] *See* https://coinmarketcap.com/ (visited April 12, 2021).

to whom, and the like. The middleman, in turn, got paid for performing these functions. Those payments took the form of loan origination fees, minimum balance fees, late fees, recordation fees, and many others. But those functions and their associated fees were not any more necessary *a priori* than postage is necessary to send a letter to another person. In the same way that email eliminated the need to buy a stamp to send a message to someone, technology arose that allows many financial functions to be performed by computer rather than by human beings. The most advanced technology for doing that is called blockchain.

In a true public blockchain, the inducement for any given person to connect their computer to the network and maintain the ledger is the promise of receiving a reward for doing so. The reward is in the form of the token native to the given blockchain being maintained.[23] This is why decentralization requires cryptocurrencies. But it also helps explain why cryptocurrencies actually ***do*** have value and actually ***are*** backed by something, contrary to the popular understanding. The native token for any given blockchain represents the value and adoption trajectory of that particular network – it is a more direct way of investing in the actual Internet protocol than we have for investing in the original Internet, where the best proxy for Internet adoption is perhaps Google stock or the stock of another large Internet portal.

Like the original Internet, blockchain networks powered by native crypto tokens not only transfer value directly, but sometimes also serve as the framework on which other Internet applications are built. One category of application directly relevant to banking consists of so-called stablecoins, crypto tokens that are created and transmitted on a blockchain but that are pegged in value to some underlying asset (usually fiat currency) and that perform the same function as payment cards or travelers' checks. US dollar-backed stablecoins currently total in

[23] *See generally* Paul Vigna & Michael Casey, *The Age of Cryptocurrency*, chapter 5 (2015).

the tens of billions of units in circulation and hold the promise of providing real-time payments and settlements long before any realistic government-created project is expected to become available in this country. For a stable cryptoeconomy to develop, at least three things must coexist: blockchains, performing the function of ledger management and transaction rails; cryptocurrencies native to each blockchain to reward unrelated parties for validating transactions and maintaining the network and its ledger; and stablecoins, which allow for instant transactions without the price volatility that often makes cryptocurrencies a less-than-optimal means of payment.

The next frontier of decentralization is decentralized finance, or "DeFi" – a phenomenon I termed "self-driving banks" because of their similarity in the financial world to self-driving cars being tested on roads across America.[24] The concept of DeFi is that, not only can value be transmitted over Internet-like public blockchains, but ***other*** functions of banks and broker-dealers can be conducted away from any centrally controlled institution. Savings, lending, capital allocation – all conducted by open-source software with little human involvement and no central management.[25] The trick, however, is that participants in DeFi networks are lending or borrowing or saving or shorting crypto assets rather than fiat currency or traditional securities. But from the standpoint of the participant, it may not matter that they are using a stablecoin or a cryptocurrency if, unlike at their bank, they can receive the now-astonishing sum of 8.6 percent interest.[26]

---

[24] Brian P. Brooks, *Get Ready for Self-Driving Banks*, Financial Times, January 12, 2021.

[25] *See* https://forkast.news/explainer-decentralized-finance-defi-guide/#:~:text=DeFi%20are%20financial%20services%20with,blockchain%20technology%2C%20in%20layman's%20terms.

[26] As advertised at https://blockfi.com/ (visited April 12, 2021).

Why are top US computer scientists devoting their careers to cryptocurrency projects, and why are Americans and others around the world flocking to the asset class? Again, contrary to the popular narrative, there are articulable reasons. One is that decentralized networks are almost always faster, cheaper, and more resilient than single points of failure. Yes, cryptocurrency exchanges get hacked from time to time, but so do credit bureaus, banks, broker-dealers, and other traditional institutions. On the other hand, as a popular meme has it, "the Fedwire is down. Bitcoin never goes down." Or perhaps more familiarly, the library closes at 5 pm – the Internet never closes. Another reason for increasing cryptocurrency adoption is the idea that the preprogrammed scarcity of certain cryptocurrencies, including Bitcoin, provides a hedge against inflationary monetary policy.[27] And third, in a world characterized by political polarization of everything from social media platforms to lending to payments, in the world of cryptocurrency, there is no human decisionmaker to prohibit a person from sending money to the recipient of his or her choice on ideological grounds.

Unbundling and Decentralization Present Regulatory Policy Challenges, But Not Insurmountable Ones.

1. **Can – and *Should* – Unbundled Financial Services Companies Receive National Bank Charters?**

Since the time of Comptroller Thomas Curry, the OCC's position under leadership from both political parties has been that companies engaging in one or more core banking activities – deposit-taking, lending, or payments – are potentially eligible to receive national bank charters. Opposition to this idea has been premised significantly on (a) concerns about protecting incumbent banks and (b) protecting the turf of state regulators to solely license nonbank financial

[27] Vigna & Casey at 294.

companies while simultaneously enjoying the power in tandem with the federal government to charter banks.

While the legality of chartering nondepository financial services companies as banks is currently being litigated in the Second Circuit Court of Appeals, in my opinion the analysis is not complicated. The National Bank Act, under which banks are chartered, nowhere requires banks to take deposits. Deposit-taking is a ***power*** of national banks, not a requirement. Throughout history there have been nondepository banks, both in this country and elsewhere; credit card banks and national trust banks are examples. And a long line of judicial decisions, including from the Supreme Court, has deferred to the OCC's interpretation of which powers banks may or must exercise.[28] This is as it should be, since banks, like all business organizations, have had to evolve and adapt over the years to keep up with changing consumer preferences, a changing market environment, competition from new products and technologies, and other things.

But the legality of nondepository bank charters will be decided by the courts, and probably soon. What should American ***policy*** be on this subject? None of the policy arguments against the OCC's authority to charter nondepository banks is especially persuasive. A national bank charter for nondepositories will not destroy the dual banking system as some critics claim; today states and the federal government charter banks in parity with each other, so why should only the states charter nondepository companies engaged in banking activities such as lending and payments? A state monopoly on such licensing authority is hardly ***dual*** banking.

A state-centric model for lending and payments platforms is hardly consistent with national economic growth. All such a model ensures is that some of our largest and most efficient innovators – global payments companies, national marketplace lenders, and others –

---

[28] *See, e.g., Nationsbank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995).

must pay a state-by-state regulatory tax for the privilege of serving customers all over the country. They could certainly do that if they choose, but must they?

Nor is a system of state licensing monopolies necessary to ensure robust consumer protection. No bank operating under OCC supervision would claim that federal regulation is lighter-touch than state regulation. In my short tenure at the OCC, I personally authorized roughly $1 billion in civil money penalties against banks that had violated consumer protection and other laws. By contrast, many state-licensed entities, ranging from payday lenders to subprime mortgage lenders, have a history of consumer protection violations that do not necessarily reflect well on the state regulatory system that supposedly supervises them.

None of this is to impugn the effectiveness of state banking regulators or the importance of state bank charters, which play a vital role in our system. Indeed, many important regulatory innovations have arisen in state laboratories of experimentation, ranging from industrial loan companies which have played an important role in specialty financial services for more than a century to cutting-edge crypto bank charters being explored in places like Wyoming. But as the founders recognized in jettisoning the Articles of Confederation for the Constitution, and as Alexander Hamilton recognized in organizing the first Bank of the United States, a country based on a fragmented economy in which each state acts as mini-sovereign will not be a robust competitor on the international stage and will not experience the kind of growth and wealth creation that Americans expect as their birthright. This point is all the more compelling given the simultaneous decline of branch banking and rise of online financial services. In such a world, arbitrary geographic limitations that may have made sense two generations ago make little sense today.

2. Can Regulation Adapt to the Decentralized Nature of Cryptocurrency?

In a series of releases in 2020 and 2021, various government agencies and interagency groups finally began providing clarity for the building blocks of a future cryptoeconomy. The OCC started the dialogue with an interpretive letter clarifying that national banks can provide custody services for cryptoassets held by their customers.[29] Shortly thereafter, the OCC authorized national banks to hold reserve deposits for, and otherwise support, stablecoin projects that meet certain requirements.[30] The SEC simultaneously stated that stablecoins meeting the specified criteria could request no-action letters from the SEC clarifying that they do not constitute regulated securities.[31] The OCC then clarified that banks can connect directly to blockchain networks as validator nodes for purposes of both accepting and remitting stablecoin payments and maintaining the blockchain networks on which stablecoins transact.[32] Underscoring the importance of these issues to national economic policy, the President's Working Group on Financial Markets provided additional clarity on expectations surrounding stablecoins and their related networks, including both the set of safety-and-soundness requirements to ensure that customers can redeem their stablecoins at par on demand and a technology-agnostic approach to ensuring compliance with anti-money-laundering requirements.[33]

While this policy work was going on, OCC supervision staff spent the summer and fall of 2020 working on a supervisory framework to ensure that crypto-related activity inside the federal banking system would comply with capital, risk management, compliance, and other standards

---

[29] https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-98.html.
[30] https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-125.html.
[31] https://www.sec.gov/news/public-statement/sec-finhub-statement-occ-interpretation.
[32] https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-2a.pdf.
[33] https://home.treasury.gov/system/files/136/PWG-Stablecoin-Statement-12-23-2020-CLEAN.pdf.

that are as rigorous as those expected of traditional banks. Only after career staff was satisfied did the OCC conditionally approve the first two crypto bank charters in history. As with any new banking activity, both the banks and the regulators will learn in the early days. But I am proud that my former colleagues did the work necessary to understand and evaluate this emerging class of assets and activities to ensure that it can safely be brought into the U.S. financial system subject to prudent risk management and consumer protection.

3. How to Assess Financial Inclusion

Depositories are subject to the financial inclusion requirements embodied in the Community Reinvestment Act (CRA). The CRA is an important civil rights law that embodies a basic social contract: Institutions that gather artificially cheap retail deposit funding (artificially cheap because deposits are insured by the Federal Deposit Insurance Corporation) in a given community should reinvest a portion of the benefit of their low funding costs in that community. Nondepositories by definition don't receive the benefit of cheap deposit funding and thus, as a technical matter, the terms of the CRA do not apply. And yet if the events of Summer 2020 taught us nothing else, it is that financial inclusion is critical for social peace and cohesion in this country. Thus one challenge facing the OCC and other banking regulators, not to mention you and your colleagues in Congress, is how to think about an appropriate means of assessing financial inclusion for nondepository financial services companies. Importantly, fintech is all about financial inclusion because the primary business model involves providing financial services to individuals not well served by traditional banks. And fintechs, at least those in the lending business, are subject to the same antidiscrimination laws – the Equal Credit Opportunity Act, the Fair Housing Act, and potentially others – as banks.

Still, more rigorous thinking needs to be done about the appropriate measure of a sustainably profitable fintech's contribution to its community. We should be cautious about politicizing technology innovation because, as members of this panel have pointed out before, banks that are themselves subject to CRA do not always do a perfect job of serving all segments of their communities. Innovators exert market pressure on banks to up their game, and also make it easier for banks to serve underserved segments of the market. But one of the reasons I founded Project REACh at the OCC was precisely to explore ways that technology innovators and banks can work together to solve the structural issues behind race disparities in access to credit – issues such as the disproportionate number of racial minorities that lack a usable credit score, or the difficulty that disproportionately many minorities have in saving for a house down payment. Fintech has something to teach us on these and many other financial inclusion subjects. I encourage you and your colleagues to unleash their energies – not to disincentivize them. Working together, we can harness market forces to build a financial system that is simultaneously inclusive and innovative.

Testimony before the

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES
Subcommittee on Consumer Protection and Financial Institutions

Regarding

"Banking Innovation or Regulatory Evasion?

Exploring Trends in Financial Institution Charters"

April 15, 2021

Raúl Carrillo, Esq.
Associate Research Scholar, Yale Law School
Deputy Director, Law and Political Economy Project

Summary

Chair Perlmutter, Ranking Member Leutkenmeyer, and Members of the Subcommittee, thank you for inviting me to this hearing. I offer my testimony as an attorney, an Associate Research Scholar at Yale Law School, and Deputy Director, Law and Political Economy Project.[1] I have previously served as Special Counsel to the Enforcement Director of the Consumer Financial Protection Bureau (CFPB) and worked as a Staff Attorney at New Economy Project in New York City, fighting on behalf of the low-income and ("no-income") people of New York City. I appeared before the Financial Technology Task Force last

[1] "The Law and Political Economy (LPE) Project brings together a network of scholars, practitioners, and students working to develop innovative intellectual, pedagogical, and political interventions to advance the study of political economy and law. Our work is rooted in the insight that politics and the economy cannot be separated and that both are constructed in essential respects by law. We believe that developments over the last several decades in legal scholarship and policy helped to facilitate rising inequality and precarity, political alienation, the entrenchment of racial hierarchies and intersectional exploitation, and ecological and social catastrophe. We aim to help reverse these trends by supporting scholarly work that maps where we have gone wrong, and that develops ideas and proposals to democratize our political economy and build a more just, equal, and sustainable future." https://lpeproject.org/.

September as Policy Counsel to the Demand Progress Education Fund (DPEF)[2] and a Fellow at the Americans for Financial Reform Education Fund (AFR Education Fund).[3]

My previous remarks humbly requested that policymakers consider the deeper impacts of nascent financial technologies on democracy and society. My remarks today echo these same themes. I respectfully urge Congress to acknowledge the true extent to which law and especially legislation are already governing the "fintech" space. We should not imagine that law and technology are separate or that the law needs to "catch up with technology." Rather, the law permits the technologies we are discussing today to exist. The pandemic response has cast into relief the fundamental ways in which Congress helps manage money and markets at the systems design level. New fintech does not appear as from nowhere; rather, it grows and flows from existing legal arrangements with all their idiosyncrasies and flaws. People who claim to separate law from technology, technology from politics, or politics from law are typically telling an inaccurate or incomplete story. As with the technology itself, humans build and use the legal tools at their disposal with certain ideas for their usage in mind.[4]

This morning, I have the luxury of presenting alongside Professor Kristin Johnson and other likeminded colleagues, and will thus merely refer to you my previous testimony for comments regarding algorithmic discrimination, capital markets, operational security and resiliency, and many themes of macroprudential regulation. Today I will focus on three core themes, which are intended to address the specific regulatory concerns highlighted by the Subcommittee in the Hearing Memo:

1) **Congress should pursue and support financial institutions' charter policies that protect the safety and soundness of U.S. monetary, banking, and financial systems as public "infrastructure" used not only by businesses, but everyday people around the world.** In general, I echo previous calls for policymakers to adopt a bright-line, precautionary approach to digital "bank-like" activities.[5] What industry calls "innovation" is often easily mapped to a longstanding financial service and therefore the substance of existing laws should govern.

---

[2] DPEF is a fiscally-sponsored project of New Venture Fund, a 501(c)3 organization. DPEF and our more than two million affiliated activists seek to protect the democratic character of the internet — and wield it to render government accountable and contest concentrated corporate power.
[3] AFR Education Fund is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR Education Fund include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.
[4] As Frank Pasquale details, we should not envision technology as a replacement of the human with the machine, but another another recalibration of a sociotechnical system of human decisionmakers and machine-aided decision analysis. *See* FRANK PASQUALE, THE NEW LAWS OF ROBOTICS (2020).
[5] *See, e.g.* Saule T. Omarova, *Dealing with Disruption: Emerging Approaches to Fintech Regulation*, 61 WASH. U. J.L. & POL'Y 27, 34-36 (2020) (discussing the problem with "smart" regulation: regulation that is "iterative, flexible, carefully tailored, risk-sensitive, and innovation-friendly."); JULIE E. COHEN, BETWEEN TRUTH AND POWER: THE LEGAL CONSTRUCTIONS OF INFORMATIONAL CAPITALISM 174, 182-187 (2019) (underscoring the importance of understanding platform digital activities in order to meet systemic threats).

At the same time, certain tools and certain forms of partnerships should have no place in our economy whatsoever -- whether they "evade" or arbitrage existing regulations or not. Money, payments, banking -- these are part of our very constitutional order and demand respect. Treating innovation as an unqualified good leads regulators to ignore both considerations of equity, privacy, safety, and the sort of long-term, sustainable, cooperative innovation that allows us all to truly prosper together. Given the interface between powerful corporations, complex products, and the broader public, precaution should be the norm, as it should be in food and drug regulation.[6]Although it is indispensably important to classify and assign regulatory responsibility for new products and the specific business relationships that enable them, Congress should not lose sight of its legislative purview over money, banking, and finance. That is to say, we should also discuss policy at the level of systems design via Congressional authority over matters involving the "public purse.

2) **Congress should reconsider the value "of vague but popular goals of "financial inclusion" & "access to credit", especially in light of the evolving surveillance-based business models used by fintech companies that violate our civil rights & liberties.** A bank account is not the answer to every problem; credit is not a cure for poverty. If we have learned anything from approximately 250 years of U.S. governance of money, banking, and finance, it is that we shouldn't trust business (or government agencies) just because they claim to have new technologies that obviate the need to comply with the law. We do not trust claims of privacy, security, or stability merely when they are asserted by people who stand to benefit lucratively from the blind acceptance of promises. At the product, firm, or systems level. That would be imprudent and poor stewardship over the machinery at the center of our broader economy.

   Even more importantly, we should not consign everyday people to accepting unnecessary and dangerous invasion of their privacy in order to participate in the payments system. We all deserve to participate in the broader economy and society without perpetual surveillance, to be "one in the crowd", as suggested by the Fourth Amendment, the First Amendment, and the law against general warrants that precedes them both. Currently, federal privacy law offers little meaningful protection to citizens against mass surveillance by their own government. This should be a subject of extreme concern regardless of political party affiliation.

3) **Congress should establish a framework for public sector financial services.** Innovation in this space is simply too important to leave to the private sector. This begins with properly respecting and stewarding our existing analog systems. The ongoing "War on Cash" assails our most democratic constitutional principles and aspirations with respect to monetary provisioning and privacy therein. The Court's legal tender doctrine, Fourth Amendment doctrine, and First Amendment doctrine could

[6] Cohen, *supra* note 5, at 91-92.

arguably be interpreted as providing constitutional protection to cash as a payment technology. Regardless, bans on paper cash should be prevented by federal legislation. Even more importantly, any provision of public services, including a public option for financial services, must preserve a place in our monetary design for a digital equivalent to *cash wallets* as well as *bank accounts*. While legal firewalls might prevent some level of abuse in a public ledger system, technological solutions are also required. In the context of privacy law, cash in "closed containers" affords substantially more obscurity (if not anonymity, nor necessarily secrecy) to users as we go about our everyday lives. We can circulate both analog and digital cash in a manner that respects some of the most democratic U.S. constitutional traditions.

Charter Policy: Money, Banking, & Finance as "Infrastructure"

Background

The Bill of Rights clearly recognized the right to privacy and protection from unreasonable searches and seizures are both fundamental liberty interests. The Fourth Amendment was created to protect American citizens from the type of government invasions rampant under King George that allowed British soldiers to invade the colonists' homes in search of anti-monarchists.[7] The law of search and seizure can be seen as the consequence of the strong tradition of using law as a shield for associational freedom and free speech.[8] The Third Amendment can also be read this way.[9]

There was less agreement among colonists as to how the monetary system should work. Many colonists came to the colonies to escape their debts. Throughout the 18th century, the question of who had the power to issue legal tender (the best method of debt cancellation) was a contentious one between the British Crown, Parliament, and American colonial governments. Nevertheless, the Constitution shifted the power to regulate money, debt, credit contracts, and tax forgiveness to the federal government.[10] Banking regulation flows from this constitutional authority over money itself. NIn various ways, scholars have argued the government has delegated some of its "money-creation" power to banks.[11] Indeed, 33 banking law scholars

---

[7] William Pitt, Earl of Chatham, Speech on the Excise Bill in the House of Commons (Mar. 1763).
[8] Deven R. Desai, *Constitutional Limits on Surveillance: Associational Freedom in the Age of Data Hoarding*, 90 Notre Dame L. Rev. 579, 602 (2014).
[9] *The Intolerable Acts: American Revolution*, PORTLAND STATE UNIVERSITY COLLEGE OF URBAN & PUBLIC AFFAIRS, http://www.upa.pdx.edu/IMS/currentprojects/TAHv3/Content/PDFs/Intolerable_Acts.pdf (last visited Mar. 5, 2017) (The Third Amendment was a response to the Quartering Acts of 1765 and 1774, which were called the "Intolerable Acts" by American revolutionaries.).
[10] U.S. CONST. art. I, § 10.
[11] *See, e.g.*, Robert C. Hockett & Saule T. Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143, 1147 (2017) ("At its core, the modern financial system is effectively a public-private partnership ...."); MORGAN RICKS, THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION (2016); CHRISTINE DESAN, MAKING MONEY: COIN, CURRENCY, AND THE COMING OF CAPITALISM (2014); Katharina Pistor, *A Legal Theory of Finance*, 41 J. COMP. ECON., 315, 315 (2013) ("[F]inancial markets are legally constructed and as such occupy an essentially hybrid place between state and market, public and private.").

submitted an amicus brief to the Second Circuit with respect to *Lacewell v. OCC*, arguing that "[c]reating deposit dollars is a delegated sovereign privilege" and that OCC lacks the authority to charter Silicon Valley firms.[12] In his "money as infrastructure" view, legal scholar Morgan Ricks frames *bank chartering* as procurement.[13] Following the Civil War, only state-chartered or nationally-chartered institutions have been allowed to incur bank deposit liabilities, creating a logical site for regulation. But myriad forces, including the Law and Economics movement, have driven a proverbial "race to the bottom" in terms of charter-based enforcement.[14]

National Bank Charters & Special Purpose National Bank Charters

Like authority over money itself, governments maintain authority over terms of credit. Since the American Revolution, states have set interest rate caps to protect their residents from predatory lending. Courts have long rejected efforts to evade usury laws, looking beyond the technical form of a transaction and toward its substance. However, beginning with a 1978 Supreme Court decision, a combination of federal and state law changes eliminated rate caps for most banks. Still the vast majority of states retain interest rate limits for longer-term loans by *nonbank companies*.[15] Around one in three states also maintain interest limits for shorter loans.[16]

The existing regulatory framework allows nonbank companies to "rent" a bank charter in order to evade state consumer protection laws. The recent "Madden-fix rules" adopted by the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), as well as the OCC's proposed "true lender rule" -- which I strongly support repealing via the Congressional Review Act -- is strongly exacerbated by this problem.

Some bank and non-bank company partnerships may provide important benefits to individual customers. But others exist primarily as a means for the nonbank company to "rent" a bank charter in order to evade state and federal consumer protection laws.[17] Banks are also subject to the (now weakened) Community Reinvestment Act (CRA) and are able to export interest rates they charge that are allowable under their home state to borrowers in other states, even if those other jurisdictions have stricter usury laws.

---

[12] Brief of Thirty-Three Banking Law Scholars as Amici Curiae in Support of Appellee in *Lacewell v. OCC*, No. 19 Civ. 4271 (2d Cir. July 29, 2020), *available at* https://justmoney.org/lacewell-v-occ/.
[13] *See* generally, Morgan Ricks, *Money As Infrastructure*, 2018 COLUM. BUS. L. REV 757 (2018)
[14] *See* William K. Black, *Neo-Classical Economic Theories, Methodology, and Praxis Optimize Criminogenic Environments and Produce Recurrent, Intensifying Crises*, 44 CREIGHTON L. REV. 597, 628 (2011) (arguing these scholars wrongly assert that competition among the States to charter corporations acts like an 'invisible hand' to align the interests of investors and officers and produce governance rules that are 'optimal for society.)'
[15] For example, 43 states and the District of Columbia cap the rate on a $500, 6-month loan, at a median of about 36%. NAT'L CONSUMER LAW CTR. (NCLC), STATE RATE CAPS FOR $500 AND $2,000 LOANS, (2020), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/FactSheet-StateRateCap.pdf.
In addition, in recent years, votes in many states, including Arizona, Colorado, Montana, and South Dakota have approved rate cap initiatives that eliminate both short-term and longer-term high-cost loans.
[16] CRL, MAP OF U.S. PAYDAY INTEREST RATES (2019), https://www.responsiblelending.org/research-publication/map-us-payday-interest-rates.
[17] *See generally* Letter from Center for Responsible Lending (CRL) et al. to OCC (Sept. 3, 2020), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/OCC-True-Lender-Comments.pdf ("CRL et al. True Lender Comments").

For now, it appears the OCC lacks the authority to extend national bank charters to companies that do not hold deposits and are not banks in any traditional sense of the word.[18] But lending charters would simply be dangerous. Predatory lenders are eager to obtain national bank charters so that they can ignore state usury laws and charge rates that are illegal under most state laws. The OCC is already supporting predatory lenders that partner with national banks to evade state interest rate caps, and doing nothing to restrain the banks' role in predatory practices,[19] and I do not have confidence that a nonbank charter would not be available to predatory lenders. Moreover, the OCC does not intend for SPBNC recipients to be subject to the CRA, which only applies to depository institutions, creating a higher risk they would offer products that harm the communities where they do business rather than serve these communities with responsible products.

Industrial Loan Charters

Wall Street and Silicon Valley should not be permitted to intertwist any further.[20] Historically, commercially-owned banks have made unsound loans to business partners, denied services to competitors, and generally engaged in imprudent activities to spur commercial user purchases.[21] Commercial firms that also engage in financial services tend to use such enterprises to fund other risky business activities, heightening the moral hazard of bailout.[22] The risk of predatory behavior increases. Allowing Big Tech to take advantage of federal deposit insurance and other attendant protections (without concomitant responsibilities) threatens responsible practices within the tech sector overall. Just as distressingly, allowing Big Tech to engage in shadow banking activity jeopardizes financial stability.[23] These combinations should not be allowed. As a general matter, any companies acting as banks — regardless of the financial or nonfinancial nature of their parent companies — should be regulated as banks, under consolidated supervision. Companies acting as BHCs should be regulated as BHCs. It is time to permanently end the ILC exemption: I thus support the "Close the ILC Loophole" Act (C. Garcia), which would eliminate an exemption to the Bank Holding Company Act that permits ILCs and their corporate owners.

I am especially concerned by the encroachment of dominant platforms into the payments space. Big Tech companies use their "platform privilege" not only to analyze users, but to acquire and appropriate from competitors that rely on the infrastructure they supply. In late June

[18] Letter from NCLC to OCC 9 (Aug. 3, 2020), https://www.nclc.org/images/pdf/rulemaking/2020-OCC-fintech-NCLC-comments.pdf.
[19] *Id.* at 52-57.
[20] *See* Comment from Arthur E. Wilmarth, Jr., Prof. of Law, Geo. Wash. Univ. L. Sch., to FDIC (Apr. 10, 2020), https://www.fdic.gov/regulations/laws/federal/2020/2020-parent-companies-of-industrial-banks-3064-af31-c-002.pdf.
[21] Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN L. REV. 1539, 1598-1606 (2007).
[22] *Id.* at 1569.
[23] For relevant background, see, e.g., L. Randall Wray, *Global Financial Crisis: Causes, Bail-Out, Future Draft*, 80 UMKC L. REV. 1101, 1107 (2012) (describing how the shift of economic power to shadow banks triggered the operation of "Gresham's Law", whereby safer and stabler financial firms were driven out of business).

2020, the AFR Ed Fund and Demand Progress Ed Fund released the "Libra Black Paper", arguing policymakers should prevent Facebook and the Geneva-based Libra Association — a cartel of junior Silicon Valley partners — from moving forward with their global corporate currency project.[24] I encourage this subcommittee to read that report. Although the Facebook-driven Project has rebranded itself as "Diem", my fundamental concerns, especially with respect to surveillance remain. To put it bluntly, Facebook stands to leverage its platform power to expand its digital advertising monopoly, take over adjacent markets, self-deal, and establish a global surveillance system. The Diem Association would constantly, affirmatively monitor the Diem network for suspicious activity. There would be no real privacy.

Federal Payments Charters

Digital wallets systems that store cryptocurrency (like most mobile money platforms, including PayPal and Venmo) do not simply transfer funds, but store balances unprotected by federal deposit insurance, or any equivalent mechanism.[25] By avoiding custody agreements with FDIC-insured institutions, mobile payment companies avoid most banking regulation, constituting "shadow payment platforms."[26] In the event of disaster, the last line of defense is general corporate bankruptcy law.[27] Money Services Business (MSB) designation provides a shallow consumer protection arrangement, primarily in the form of mandated disclosure.[28] Fifty different state MSB regulators also apply a mix of minimum net worth requirements, surety bond, and other security and investment requirements.[29] These laws have proven ineffective in keeping MSBs afloat.[30] Some cryptocurrency advocates have framed the product as means of improving remittances, especially for low-income and excluded populations.[31] Critiques of cryptocurrency have largely responded in kind, by focusing on their implications for money laundering concerns. When one steps back and considers the state of money, currency, and the financial system in the U.S., however, cryptocurrency looks less like a significant departure from

---

[24] Raúl Carrillo, Banking on Surveillance: The Libra Black Paper, AFR Education Fund & DPEF (2020), https://ourfinancialsecurity.org/wp-content/uploads/2020/06/Libra-Black-Paper-FINAL-2.pdf.
[25] *See, e.g,* Sarah Jane Hughes & Stephen T. Middlebrook, *Advancing A Framework for Regulating Cryptocurrency Payments Intermediaries*, 32 Yale J. on Reg., 495, 527 (2015)
[26] *See* Dan Awrey & Kristin van Zwieten, *Mapping The Shadow Payment System* 41-44 (SWIFT Institute Working Paper No. 2019-00, 2019), *available at*: https://ssrn.com/abstract=3462351 (discussing comparative approaches in the U.S., UK, EU, and China).
[27] *See* Dan Awrey, *Bad Money,* 106 Cornell L. Rev. 1, 23 (forthcoming 2020), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3532681 (discussing how the corporate bankruptcy regime fails depositors). *See also* Ryan Surujnath, *Off the Chain! A Guide to Blockchain Derivatives Markets and the Implications on Systemic Risk*, 22 Fordham J. Corp. & Fin. L. 257, 301 (2017) (discussing how this dynamic can be especially dangerous when distributed ledger technology (DLT) is involved, as a lack of clear transaction finality may make it difficult to determine liability in the context of corporate insolvency).
[28] 12 C.F.R. § 1005.3. *See also* Dan Awrey, *Bad Money,* 106 Cornell L. Rev. 1, 34 (forthcoming 2020), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3532681.
[29] *See* Awrey, *supra* note 28, at 34-41 (surveying the various requirements).
[30] *Id.* at 39-41.
[31] *See, e.g.*, Testimony of Mark Zuckerberg Before the Committee on Financial Services, United States House of Representatives Oct. 23, 2019.

recent trends, and more like the culmination of a move away from strict state controls over money and currency, toward additional forms of "private money" that are dangerous for users.

Some analysts have argued that mobile payments platforms should be subject to full-scale banking regulation.[32] Yet regulators lack the authority to simply designate a nonbank company, as a bank. In fact, federal laws contain several different and potentially conflicting definitions of a "bank",[33] limiting regulators ability to constrain banking activities to institutions with banking charters.[34]

Despite widespread acknowledgement that definitional problems allow nonbanks to engage in arbitrage,[35] the issues remain unresolved. Banking regulators could attempt to promulgate rules clarifying the definitions of "bank" and "deposit", but courts have generally been unwilling to expand the scope of such statutory terms.[36]

Congress must prevent the rise of a surveillance-driven shadow banking sector.[37] Congress should designate the deposit-like obligations of dominant tech platforms as "deposits", prohibiting the platforms from issuing such obligations absent review and approval by banking regulators. We need a forward-looking bill that seeks to integrate emerging digital financial technologies into traditional banking services in a way that strengthens regulatory supervision, clarifies the legal status and classification of digital financial assets, but above all, promotes safety of consumer funds. We should recognize as a deposit any digital financial asset that promises a fixed nominal value, on demand, denominated in or pegged to the U.S. dollar, and regulates the relevant institutions as depository institutions. I believe the STABLE Act recently proposed by Rep. Rashida Tlaib (D-MI) achieves these goals.[38]

---

[32] *See, e.g.*, Paul Kupiec, *Why Libra Must Be Treated Like Traditional Banks and Currency*, THE HILL (Nov. 4, 2019), https://thehill.com/opinion/finance/468924-why-libra-must-be-treated-like-traditional-banks-and-currency.

[33] For discussions of these definitions, see Saule T. Omarova & Margaret E. Tahyar, *That Which We Call A Bank: Revisiting the History of Bank Holding Company Regulation in the United States*, 31 REV. BANKING & FIN. L 113, 115 (2011).

[34] For extensive discussion, see Ricks, *supra* note 13, at 811-821 (2018). (For instance, the Banking Act of 1933 classifies "banks" as institutions that take deposits and are examined and regulated by state or federal banking authorities. Section 21 makes it illegal for an entity to accept deposits without being regulated by a banking regulator. The provision has been interpreted as an "axiomatic" statement preventing firms other than banks from issuing deposit liabilities. Prof. Wilmarth has argued that it is a criminal offense for nonbanks to hold deposits. Unfortunately, the Banking Act of 1933 does not define "deposit", meaning regulators cannot easily invoke Section 21 to prevent nonbanks from engaging in general banking activities. Even if regulators or courts were to attempt to borrow the definition of "deposit" from another statute, there would be "no practical way forward." For instance, because the Federal Deposit Insurance Act defines a "deposit" as "money or its equivalent received or held by a *bank*..." (emphasis added), this creates a "perfect legal circle.")

[35] *See, e.g.*, U.S. TREAS., FINANCIAL REGULATORY REFORM: A NEW FOUNDATION (Oct. 8, 2009), https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

[36] For instance, the Supreme Court struck down a Board regulation intended to expand the BHCA definition of "bank" to cover "nonbank banks." *See* Board of Governors v. Dimension Financial Corp, 474 U.S. 361, 374 (1986).

[37] *See* Kristin N. Johnson et al., *(Im)perfect Regulation: Virtual Currency and Other Digital Assets As Collateral*, 21 SMU SCI. & TECH. L. REV. 115, 142 (2018) (arguing that expanding the existing definition of "deposit accounts" to include virtual wallets and platforms would presumably subject them to a host of intermediary regulations imposed on more traditional depository institutions).

[38] https://tlaib.house.gov/media/press-releases/tlaib-garcia-and-lynch-stableact

Policymakers may create a narrower space for firms that do not seek to engage in broader depository activities beyond accepting funds and making payments, but all companies must be subject to regulation that matches the risks posed to consumers and the broader public. We do not expect the OCC's Payments Charter to meet this goal.[39] As it stands the OCC lacks the authority to issue its Payments Charter.[40] But as a policy matter, the decision of whether and how to grant a national payments charter should be left to Congress. A payments charter raises important issues with respect to consumer and fair lending protections, the separation of banking and commerce, and supervision of holding companies.

Advocates and scholars across the political spectrum have argued our existing charter system is broken.[41] The public deserves comprehensive, federal regulation of firms that engage in fiscal agent services, money transmitter services, and/or "pass-through" services, but are clearly not engaged in providing depository or security-based services. That being said, it is not clear the OCC is the proper institution to take charge here and the regulation flowing from a charter deserves significant and substantial attention. In particular, federal payments charters must provide a basis for the more comprehensive regulation of minimum balances or maximum balances, quantitative and qualitative regulation of fees, and privacy, security, and data management policies. Like depository institutions, payments institutions should also be subject to regulations ensure that the services provided by such institutions are universal and comprehensively include historically excluded and marginalized groups. We must generally avoid the problems already identified within the existing dual banking system. Of special importance, we should not allow the regulations that flow from federal chartering to supersede or supplant any other stronger regulations or standards promulgated by other Federal or applicable State regulatory entities, including any such regulation issued by the FDIC or CFPB.

The most fundamentally important thing we can do to protect consumers in this space is strengthen direct credit regulation. Strengthen consumer protections, including by instituting a federal usury rate cap. Interest rate limits are the simplest and most effective protection against predatory lending.[42] In May 2019, Senator Bernie Sanders and Representative Alexandria Ocasio-Cortez unveiled the Loan Shark Prevention Act, a bill that would cap the cost of consumer credit nationwide.[43] Under the bill, the total cost of a loan, calculated as an annualized percentage rate (APR), could not exceed 15%. There is also an effort to extend the 36% APR interest rate cap on payday and car-title lenders in the Military Lending Act (MLA) to cover all Americans.[44]

---

[39] See ABA, "Podcast: OCC's Brooks Plans to Unveil 'Payments Charter 1.0' This Fall," June 25, 2020.
[40] Comment from NCLC to OCC 5 (Aug. 20, 2020), https://www.nclc.org/images/pdf/rulemaking/2020-OCC-fintech-NCLC-comments.pdf.
[41] *See* Dan Awrey, Unbundling Banking, Money, and Payments (January 31, 2021). European Corporate Governance Institute - Law Working Paper No. 565/2021, Available at SSRN: https://ssrn.com/abstract=3776739 or http://dx.doi.org/10.2139/ssrn.3776739.
[42] NCLC, Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers Who Will Default, (2016), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-misaligned-incentives.pdf.
[43] https://www.govtrack.us/congress/bills/116/s1389/text/is
[44] *See, e.g,* Letter from CRL, Ams. for Fin. Reform, et al. to Leaders McConnell and Schumer, Speaker Pelosi and Leader McCarthy (July 1, 2020),

Civil Rights, Civil Liberties, & "Financial Inclusion"

Background: Data Governance

Many claims are made about the promise of Big Data to increase financial inclusion, but those claims fail to reckon with, much less solve, the systemic reasons people are left out or more accurately deliberately excluded. Too often, promises of technological empowerment yield "predatory inclusion" — a process whereby financial institutions offer needed services to specific classes of users, but on exploitative terms that limit or eliminate their long-term benefits.[45]

"Access to credit" talk pervades the current discourse of financial rights and equality for low-income communities. However, legal scholar Abbye Atkinson has argued, in concert with community advocates, the notion that credit is a valid form of social provision for low-income Americans, however, is deeply flawed.[46] At its best, credit is a mechanism of intertemporal and intrapersonal redistribution. The problem of entrenched and enduring poverty that leaves people consistently unable to afford basic necessities cannot be addressed by a device that requires future prosperity and economic growth. Indeed, the mechanism is fundamentally extractive. Too often, discussions about financial access disparities focus on the choices and behaviors of individuals, or on the need to design "alternative products," rather than on structural barriers that block poor people, immigrants, and people of color from mainstream financial institutions and systems. Atkinson highlights that this sort of rhetoric is popular in both political parties.[47]

Mass financial surveillance adds another dimension to financial inclusion, eventually creating a detailed picture of our most private social, familial, romantic, religious, and political activities. Data about a single transaction can be linked to purchase history, creating a "picture of the person behind the payment."[48] A massive data broker industry connects data regarding our finances to data about our employment, marital status, homeownership status, medical conditions, and even our interests and hobbies. Powerful institutions can make predictions with tremendous precision, in real-time, and at scale. The exponential growth in computer processing

https://ourfinancialsecurity.org/wp-content/uploads/2020/03/CRL-Group-Letter-on-Financial-Services-Stimulus-Recommendations.pdf (All new loans made during the crisis should comply with consumer safeguards in the Military Lending Act, including a cap of 36% APR.)

[45] Louise Seamster & Raphaël Charron-Chénier, *Predatory Inclusion and Education Debt: Rethinking the Racial Wealth Gap*, 4 Soc. Currents 199, 199-200 (2017) (describing the targeting of mortgagors and students who borrow to purchase homes or education as "predatory inclusion."). Keeanga Yahmatta-Taylor uses "predatory inclusion" in the housing context - "[T]he turn to inclusion was only allowable by maintaining other forms of exclusion. Credit inclusion became possible by holding the line on neighbor exclusion. Keeanga Yahmatta-Taylor, Race for Profit: How Banks and the Real Estate Industry Undermined Black Homeownership 254 (2019). *See also* Kristin Johnson et al., *Artificial Intelligence, Machine Learning, and Bias in Finance: Toward Responsible Innovation*, 88 Fordham L. Rev. 499, 505, 517–21 (2019) (arguing fintech firms may "hardwire predatory inclusion" into financial markets for the "next several generations").

[46] Abbye Atkinson, *Rethinking Credit As Social Provision*, 71 Stan. L. Rev. 1093, 1093–94 (2019).

[47] *Id.* at 1093.

[48] Albert Fox Cahn & Melissa Giddings, *In the Age of COVID-19, the Credit Card Knows All*, Surveillance Technology Oversight Project - Urban Justice Center (May 18, 2010), https://www.stopspying.org/latest-news/2020/5/18/in-the-age-of-covid-19-the-credit-card-knows-all.

power has rapidly changed how much information can be generated, and how much can be stored and analyzed at minimal cost to the surveiller. From the perspective of a human mind, there is too much data to process, the sets are too heterogeneous to make sense of, and the speed of analysis necessary to process them surpasses our abilities.[49] Predictive analytics takes surface data and infers latent data from it. A mostly unregulated data broker industry then connects to even more stocks of data regarding employment, marital status, homeownership status, medical conditions, and even our interests and hobbies, especially as articulated via social media.

For purposes of preventing payments data collection in the first place, FCRA remains the most relevant statute. FCRA was drafted before concentrated computerized data sharing became the standard industry business model.[50] FCRA restricted data procurement to "a legitimate business need." This was an easy provision to satisfy; the bureaus have easily argued that direct mail and targeted advertising programs constitute legitimate business needs. FCRA includes recursive definitions of "consumer reporting agency" and "consumer report" - consumer reports are communications of credit-related information by consumer reporting agencies. Today, the largest consumer reporting firms are not considered to be bound by FCRA at all. If FCRA is to make any sense by its own legislative logic, it should be expanded to encompass "alternative reporting systems."[51]

While the CFPB and FTC do have some additional tools at their disposal,[52] no overarching federal privacy law currently curbs the collection, use, and sale of personal data among corporations.[53] Experts argue the U.S. data protection and federal privacy framework is fundamentally broken, and will face imminent revision.[54] Ultimately, Congress should take action to minimize data collection to that which is narrowly tailored to permitted usages, so that many of the aforementioned anti-competitive practices become commercially unfruitful. Legislation should also shift the burden of privacy protection away from consumers, who have minimal resources to protect themselves, and toward the companies, which profit immensely from the aggregation of our data.

Millions of people are subject to data collection to which they may not have consented. This is especially true in the payments space, where counterparties between networked payment

[49] *See, e.g.,* Amy Kapczynski, *The Law of Informational Capitalism*, 129 YALE L.J. 1460, 1468 (2020).
[50] Dennis D. Hirsch, From Individual Control to Social Protection: New Paradigms for Privacy Law in the Age of Predictive Analytics, 79 Md. L. Rev. 439, 442–43 (2020)
[51] As stressed in a recent bill by Sen. Sherrod Brown. See DATA Act of 2020. https://www.washingtonpost.com/technology/2020/06/18/data-privacy-law-sherrod-brown/. There are strong arguments for total abolition of predictive analytics in finance and a return to localized, qualitative, or informal lending practices. But there is also a real concern as to what takes the place of credit scoring. Stratification economist Darrick Hamilton argues for building a bare-bones public system, as one level of legibility is necessary for vulnerable people to gain access to the formal economy. https://www.demos.org/policy-briefs/establish-public-credit-registry
[52] For extensive treatment of FTC power, see Sandeep Vaheesan, *Resurrecting "A Comprehensive Charter of Economic Liberty": The Latent Power of the Federal Trade Commission*, 19 U. PA. J. BUS. 645, 650-698 (2017)
[53] BERKELEY MEDIA STUDIES GROUP ET AL., THE TIME IS NOW: A FRAMEWORK FOR COMPREHENSIVE PRIVACY PROTECTION AND DIGITAL RIGHTS IN THE UNITED STATES, Citizen.org, (last visited Mar. 31, 2020), https://www.citizen.org/sites/default/files/privacy-and-digital-rights-for-all-framework.pdf.
[54] *See, e.g.*, Woodrow Hartzog & Neil Richards, *Privacy's Constitutional Moment and the Limits of Data Protection*, 61 B.C. L. REV. 1, 1687, 1687-88 (2020).

"stacks" are constantly exposed to each other. But the oppression that flows most directly from the collection disproportionately harms a certain sub-population. In general, more socially advantaged groups may engage in voluntary data collection that benefits them yet risks greater harm for socially disadvantaged groups.[55]

The *commercial* sharing and selling of predictions about human behaviors is only one dimension of payments technology and surveillance. We tend to obscure how the government itself is a financial data collector.[56] According to Virginia Eubanks, social welfare agencies turned to cost-cutting technologies in periods of austerity.[57] The "digital poorhouse" was erected to stand between recipients of public assistance and their rights. Payments technology is a significant part of this story, as account-based Electronic Benefits Transfer (EBT) cards have granted agencies unparalleled and unprecedented supervision over the finances of people receiving SNAP, Housing Assistance, Supplemental Security Income, Medicaid, and more. Increased surveillance compounds the violence inherent to more traditional forms of finance. As legal scholar Angela Harris argues, a spectrum of "slow violence"—the "sprawling system of surveillance, punitive discipline, and control that makes the lives of poor people profoundly unfree" dominates the "mundane world" of misdemeanor convictions, accompanies a similarly humdrum world of "payday loans, credit cards with ruinously high interest rates, for-profit colleges, and of course subprime mortgages."[58]

Reconstructing AML, CFT, and Sanctions Law

The first serious anti-money laundering statute enacted by the federal government was the Bank Secrecy Act in 1970. The BSA requires banks and other "financial institutions" to keep certain records and authorizes the Secretary of the Treasury to require such institutions and persons participating in transactions for such institutions to report financial transactions to the Secretary.[59] The Money Laundering Control Act of 1986[60] established money laundering as a crime, making the United States one of the first countries in the world to criminalize what was hitherto considered an omnipresent crime.

In 1988 Congress passed the Money Laundering Prosecution Improvements Act,[61] extending BSA regulations to every kind of financial institution. In 1992, Congress passed the

---

[55] *See generally,* Salome Viljoen, *Democratic Data: A Relational Theory For Data Governance* (November 11, 2020). Yale Law Journal, Forthcoming, Available at SSRN: https://ssrn.com/abstract=3727562 or http://dx.doi.org/10.2139/ssrn.3727562

[56] Marion Fourcade, Jeff Gordon (2020). Learning Like a State: Statecraft in the Digital Age. *Journal of Law and Political Economy*, 1(1). Retrieved from https://escholarship.org/uc/item/3k16c24g

[57] VIRGINIA EUBANKS, AUTOMATING INEQUALITY 32-34 (2017).

[58] Angela Harris, *Criminal Justice and Slow Violence in Keilee Fant v. City of Ferguson, Missouri*, LAW & POL. ECON. (May 2, 2018), https://lpeproject.org/blog/criminal-justice-and-slow-violence-in-keilee-fant-v-city-of-ferguson-missouri/.

[59] 12 U.S.C. § 1829b(a)(1); 31 U.S.C. § 5311.

[60] Money Laundering Control Act of 1986, Pub. L. No. 99-570, 100 Stat. 3207-18 (1986) (codified as amended in scattered sections of 18 and 31 U.S.C.).

[61] Money Laundering Prosecution Improvements Act of 1988, Pub. L. No. 100-690, 102 Stat. 4354 (1988) (codified in various sections of 18 and 31 U.S.C.).

Annunzio-Wylie Anti-Money Laundering Act, which required the filing of "Suspicious Activity Reports" (SARs) that were relevant to *any possible violation of law or regulation.* The consequence of the increased reporting schemes was the generation of large numbers of extraneous reports. The flood of useless information. was hardly surprising given the incentives to over-report that are built into the law. The BSA imposes strict liability for failure to file appropriate reports, but the Annunzio-Wylie Act contains a provision holding reporting entities free from liability in connection with the filing of SARs, meaning it is better to file too many reports than not enough.[62]

All financial institutions must comply with Title III of the USA PATRIOT Act, which requires they implement robust customer identification programs, commonly labeled "know your customer" (KYC) provisions.[63] Financial institutions must generally assist police investigations requiring financial information and provide specific information to law enforcement agencies, including by filing SARs. SARs that are not deemed by the FBI to have a potential nexus to terrorism are distributed for follow-up investigation by other agencies at the state, local, and federal level, as well as fusion centers, which serve as data intermediators, or platforms, for other law enforcement agencies.[64] Mass surveillance and profiling through SARs and assessments, combined with enhanced inter-agency information-sharing through "fusion centers": data aggregators authorized by Congress to "co-locate" federal, state, and local officials together to work collaboratively, along with private contractors, on the collection and analysis of intelligence concerning a broad array of potential security threats.[65] Once a SAR is filed with FinCEN, Palantir -- a company founded by Peter Thiel, also a co-founder of PayPal -- aggregates the information which is then entered with the FBI's NSAC databases and may be forwarded to any other governmental agency that requests it.[66]

One might suppose that private banking records would be afforded some protection under the Fourth Amendment's prohibition against unreasonable searches and seizures by the state, at the very least, but the Court decided that not was not the case in *U.S. v. Miller*.[67] In *United States*

---

[62] Eric J. Gouvin, Bringing Out the Big Guns: The Usa Patriot Act, Money Laundering, and the War on Terrorism, 55 Baylor L. Rev. 955, 967–68 (2003)

[63] *See*, *e.g.*, Letter from Rep. Tlaib et al., to the Treas. Sec. Steve Mnuchin, et al., (July 17, 2019), https://tlaib.house.gov/sites/tlaib.house.gov/files/Final_BWM_Regulators.pdf (arguing many Muslim and Arab Americans have been automatically labeled "high-risk" and are therefore unable to maintain access to financial services). For a history of the relevant PATRIOT Act amendments, see, e.g., Maria A. de Dios, *The Sixth Pillar of Anti-Money Laundering Compliance: Balancing Effective Enforcement with Financial Privacy*, 10 BROOK J. CORP. FIN & COM. L. 495 (2016).

[64] U.S. GOV'T ACCOUNTABILITY OFF., ADDITIONAL ACTIONS COULD HELP ENSURE THAT EFFORTS TO SHARE TERRORISM-RELATED SUSPICIOUS ACTIVITY REPORTS ARE EFFECTIVE (2013), https://www.gao.gov/assets/660/652995.pdf [https://perma.cc/JPC5-4C5H]. (explaining how different state and local law enforcement agencies follow-up on non-terrorism SARs).

[65] Anil Kalhan, *Immigration Surveillance*, 74 Md. L. Rev. 1, 40 (2014).

[66] Cheryl R. Lee, *Constitutional Cash: Are Banks Guilty of Racial Profiling in Implementing the United States PATRIOT Act?*, 11 MICH. J. RACE & L. 557, 564 (2006) (arguing the Patriot Act 'puts banks in the business of practicing selective enforcement and racial profiling with every transaction, every hour of every business day").

[67] Appalled legislators would pass the Right to Financial Privacy Act of 1978, which bars government agencies from obtaining customer records maintained by financial institutions unless: 1) the customer authorizes the disclosure, 2) the government authority obtains an administrative subpoena, an administrative summons, a search warrant, or a judicial subpoena, or 3) the government authority makes a formal written request to the financial institution.# To this

v. Miller[68] and again in *Smith v. Maryland*,[69] the Court decided that government access to third-party business records is not a search for purposes of the Fourth Amendment. The Fourth Amendment protects only reasonable expectations of privacy, but the Supreme Court claimed one cannot have an expectation of privacy in anything shared with another person. Thus, the government could collect bank records (in *Miller*) or telephone metadata (in *Smith*) without a warrant, without probable cause, and without implicating the Fourth Amendment at all.[70]

The third-party doctrine is quite literally the product of another era -- before ubiquitous networked computing, digital data, electronic communications, mobile technologies, and the commodification of information. In the 1970s, Wall Street and Silicon Valley weren't merging to create totalistic and predictive dossiers for everyone in the world. The payments industry business model *only works through networks of third parties*. And then payments data now have different lives in the law enforcement sphere. As a general matter of course, "surveillance-as-a-service" companies sell data, including financial data, to local police departments.[71]

Given these obligations, and the racial injustices perpetrated by law enforcement, we are especially concerned by suggestions that banks — on their own initiative or in partnership with tech companies — should collect more geolocation or biometric data.[72] Geolocation data

---

day, the law ostensibly threatens banks with the possibility of high statutory damages if they illegally disclose customer information to the government, but all that is required for circumvention is a written request.# There is alo a general carveout for certain law enforcement, rendering the law more of a procedural rather than substantive barrier to violations of civil liberties. The full list of exemptions is as follows: These exceptions are (1) disclosures that do not identify a particular customer; (2) disclosures that benefit the financial institution, including its security interests, government loans, and other disclosures relevant to possible violations of the law; (3) disclosures in connection with supervisory investigations and proceedings; (4) disclosures under the tax privacy provisions; (5) disclosures pursuant to other federal statutes or rules, administrative or judicial proceedings, and legitimate functions of supervisory agencies; and (6) emergency disclosures and disclosure to federal agencies charged with foreign intelligence or counter intelligence or other national security protective functions.# Law enforcement officials can avoid giving the financial institution's customer notice and an opportunity to contest only by proving that: (1) "the records being sought are relevant to a legitimate law enforcement inquiry," and (2) notification will result in one of five specified harms. See Right to Financial Privacy Act of 1978, 12 U.S.C. §§ 3402, 3403(a), (b) (1994).

[68] 425 U.S. 435, 442-43 (1976) (holding persons have no expectation of privacy in information conveyed to a bank). (the police connected the defendant to a bootlegging conspiracy by subpoenaing his bank for checks written from his business account)

[69] 442 U.S. 735, 744 (1979).

[70] As Justice Brennan observed in his dissent in *Miller*, "[f]for all practical purposes, the disclosure by individuals or business firms of their financial affairs to a bank is not entirely volitional. It is impossible to participate in the economic life of contemporary society without maintaining a bank account." Justice Marshall voiced a similar objection in *Smith* , where he asserted that "privacy is not a discrete commodity, possessed absolutely or not at all. Those who disclose certain facts to a bank or phone company for a limited business purpose need not assume that this information will be released to other persons for other purposes."

[71] SHOSHANA ZUBOFF, THE AGE OF SURVEILLANCE CAPITALISM 37 (2019).

[72] *See, e.g,* Letter from Demand Progress et al. to Leaders McConnell and Schumer, Speaker Pelosi and Leader McCarthy (July 1, 2020), https://s3.amazonaws.com/demandprogress/letters/2020-07-01_Facial_Recognition_Moratorium_and_Divestment_Letter_FINAL.pdf; Alfred Ng, *Facial recognition has always troubled people of color. Everyone should listen*, CNET (June 12, 2020), https://www.cnet.com/news/facial-recognition-has-always-troubled-people-of-color-everyone-should-listen/.

revealed by payment histories is uniquely difficult to anonymize.[73] Privacy and racial justice advocates vehemently oppose the use of biometric tools like facial recognition technology, iris-scanning, and palm prints.[74] Facial recognition software is likely to mislabel or misrecognize members of racial minority groups, especially Black Americans.[75] Overall, the general use of this kind of sensitive data not only increases the risk of predation by banks and civil liberties violations by governments, but security breaches by competitors and hackers.[76]

There is a further need to discuss whether AML, CFT, and sanctions law should continue to exist in their current form. SARs rarely lead to investigations of specific criminal activities, but rather feed the broader surveillance machinery.[77] Because many transactions are unnecessarily flagged, true money-laundering often continues without notice, perpetrated by multinational financial institutions, most notoriously HSBC.[78] Between 2010 and 2020, eighteen different financial institutions have received Deferred Prosecution Agreements, and at least four of them broke the same law again, and simply received another fine. This is not the sort of consequence experienced by real persons suspected of money laundering.

BuzzFeed News and the International Consortium of Investigative Journalists recently released thousands of leaked government documents known as the "FinCEN files."[79] These files contain over 2,100 SARs. Although the FinCEN files revealed only about 0.02% of the SARs that likely filed between 2011 and 2017, these records alone identify over $2 trillion in potential global money laundering. By its own logic, the SARS system is an utter failure. The secrecy of SARs, and the threat of imprisonment for revealing them through whistleblowing activity --

---

[73] *See, e.g.,* Cahn & Giddings, *supra* note 48.
[74] *See, e.g., A Biometric Backlash Is Underway — And A Backlash To The Backlash*, PYMNTS (May 17, 2019), https://www.pymnts.com/authentication/2019/biometric-backlash-privacy-law/; *Mandatory National IDs and Biometric Databases*, ELECTRONIC FRONTIER FOUND., https://www.eff.org/issues/national-ids (last visited Apr. 25, 2020).
[75] *See, e.g.,* Victoria Burton-Harris & Philip Mayor, *Wrongfully Arrested Because Face Recognition Can't Tell Black People Apart*, ACLU (June 24, 2020), https://www.aclu.org/news/privacy-technology/wrongfully-arrestedbecause.
[76] *See, e.g.*, Jason Leopold & Jessica Garrison, *US Intelligence Unit Accused Of Illegally Spying On Americans' Financial Records*, BUZZFEED (Oct. 6, 2017), https://www.buzzfeednews.com/article/jasonleopold/Us-Intelligence-unit-accused-of-illegally-spying-on (reporting that FinCEN employees have accused colleagues at the Office of Intelligence and Analysis of illegally collecting and storing private financial records); Aaron Mackey & Andrew Corker, *Secret Court Rules That the FBI's "Backdoor Searches" of Americans Violated the Fourth Amendment*, ELECTRONIC FRONTIER FOUND. (Oct. 11, 2019), https://www.eff.org/deeplinks/2019/10/secret-court-rules-fbis-backdoor-searches-americans-violated-fourth-amendment; Chen Han & Rituja Dongre, *Q&A. What Motivates Cyber-Attackers?*, TECH. INNOV. MGMT. REV. 40, 40-41 (2014), https://timreview.ca/article/838 (describing economic motivations for hacking).
[77] *See, e.g.*, Mariano-Florentino Cuéllar, *The Tenuous Relationship Between the Fight Against Money Laundering and the Disruption of Criminal Finance*, 93 J. Crim. L. & Criminology 311, 364 n.211 (2003) ("Given the information available to banks, it is striking how few investigations are instigated ....")
[78] *See, e.g.*, Press Release, Dep't of Just., HSBC Holdings Plc. And HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement (Dec. 11, 2012), https://www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations.
[79] *See* Jason Leopold, Anthony Cormier, John Templon, Tom Warren, Jeremy Singer-Vine, Scott Pham, Richard Holmes, Azeen Ghorayshi, Michael Sallah, Tanya Kozyreva & Emma Loop, *The FinCEN Files*, BuzzFeed News (Sept. 20, 2020, 1:01 PM), https://www.buzzfeednews.com/article/jasonleopold/fincen-files-financial-scandal-criminal-networks

undermines the public's ability to scrutinize the government's regulation of money laundering and undermines trust in the payments system as whole.

A recent rulemaking by FinCEN and the Board stands to make a bad situation worse. In a recent comment letter submitted on behalf of the Yale Privacy Lab and Fight for the Future, privacy lawyers Misha Guttentag and JP Schnapper-Casteras highlighted the proposed rule failed to even mention "privacy."[80]

Peace in the "War on Cash"

While we may use both cash and digital bank or tech company money to achieve the same thing – buying something in a shop – they come with different technical and social features. At the level of legal and technical design, cash requires no third party to stand between transactors. It does not affirmatively report back to a centralized system. Ledger activity, on the other hand, is increasingly accompanied by a scoring system: a closed box of algorithms which assesses our 'digital character' -- "a digital profile assessed to make inferences regarding character in terms of credibility, reliability, industriousness,responsibility, morality, and relationship choices."[81] Cash does not interact with this "sensing net" in the same way.

Cash is the most common form of payment for purchases and bill-paying, and its use is not limited to underbanked or unbanked consumers.[82] In fact, studies show high cash users also employ many other forms of payment, including credit cards, debit cards, mobile wallets, and online checkout services. It also showed that consumers make the choice to use cash for a variety of reasons: privacy, security, reliability, availability, and even its universal and egalitarian nature. Cash users are not Luddites who shun fintech; they're all kinds of people who pay with cash for a variety of legitimate and understandable reasons.

Cities, states, and storefronts that have moved toward cashlessness and coinlessness have necessarily segregated the payment system, even if that is not the intention. Unbanked consumers have little access to noncash forms of payment.[83] Without a bank account, they are unable to obtain credit or debit cards or to use other non-cash payment methods, with the possible exception of prepaid cards. Moreover, they fundamentally ask consumers to share data with third-party corporations and the government in order to gain financial inclusion. By contrast, some cities and states have enacted laws or ordinances that bar brick-and-mortar retail

[80] Comment from Yale Privacy Lab and Fight to the Future to FinCEN 5 (Dec. 22, 2020), https://www.federalreserve.gov/SECRS/2020/December/20201222/R-1726/R-1726_112720_137391_507288521968_1.pdf.

[81] *See* Tamara K. Nopper, *Digital Character in the "Scored Society": FICO, Social Networks, and the Competing Measurements of Creditworthiness, in* CAPTIVATING TECHNOLOGY: RACE, CARCERAL TECHNOSCIENCE, AND LIBERATORY IMAGINATION IN EVERYDAY LIFE 170, 170-188 (Ruha Benjamin ed., 2019), (coining and analyzing the concept of "digital character"). *See also* Danielle Keats Citron & Frank Pasquale, *The Scored Society: Due Process for Automated Predictions*, 89 WASH. L. REV. 1, 13 (2014).

[82] Cardtronics and Javelin Strategy & Research, 2020 Health of Cash Study (Feb, 2020), *available at* https://landing.cardtronics.com/hubfs/Cardtronics/Docs/Health_Of_Cash_Study_2019.pdf.

[83] Letter from Consumer Action, the Consumer Fed. of America, Ams. for Fin. Reform, Demand Progress, et al. to U.S. Sens. Kevin Cramer, Sen. Bob Menendez, and Rep. Donald M. Payne, Jr., https://www.consumer-action.org/press/articles/consumers-should-have-the-right-to-pay-retailers-with-cash.

stores from refusing to accept cash. Rep. Ritchie Torres (D-NY) has been at the forefront of this effort in New York City. Led by Rep. Donald Payne, a coalition in New Jersey advanced the first state-level bill in nearly fifty years to ban cashless retailers, which was signed into law by the governor in March 2019. Conglomerates such as Amazon are pushing back, worried that the bill circumvents their heavy investment in their cashless brick-and-mortar bookstores and future grocery stores. Aware of both states' and cities' responses towards the anti-cash movement, Congress joined the effort and introduced two cash discrimination bills in 2019, including one authored by Payne.[84]

Building a Public Option for Financial Services

Background

The fintech industry's "endless capacity for self-referential growth"[85] suggests prudence. In fact, it can only be disciplined by policymakers' own forward thinking about services people actually need in an informational economy.[86] Policymakers must avoid being swayed by general promises of innovation and create systems specifically designed for real accountability on behalf of the public. Congress is the proper body for this discussion.

One response to some of the privacy issues discussed throughout this testimony is cryptocurrency. The idea of an anonymous (or pseudonymous) and cryptographic currency developed over the course of the 1990s.[87] Since this initial phase, distributed ledger technology (DLT) including "blockchain", has helped create over 700 cryptocurrencies, most famously Bitcoin.[88] Cryptocurrencies are ostensibly token-based monies, but operate using ledgers wherein transactions are validated via encryption. DLT allows all users to record transactions and third parties to verify them. The ledger thus replaces bank ledger systems, ostensibly ensuring everyone really has the financial wherewithal that they claim and are not seeking to complete transactions with resources that they do not actually possess.

Proponents of cryptocurrencies at once stress their transparency and privacy, as distributed ledgers are essentially held in common rather than "owned" by an intermediary. Advocates of blockchain are inclined to suggest that blockchain is *necessarily* decentralized or

[84] *See also* Meera Jagannathan, "World Health Organization: We did NOT say that cash was transmitting the coronavirus," MarketWatch (March 9, 2020), *available at* https://www.marketatch.com/story/who-we-did-not-say-that-cash-was-transmitting-coronavirus-2020-03-06. (neither the World Health Organization (WHO) nor the Centers for Disease Control and Prevention (CDC) have concluded that cash presents any more danger than credit cards or other forms of payment).

[85] *Fintech: Examining Digitization, Data, and Technology: Hearing Before the U.S. S. Comm. on Banking, Hous., and Urban Affairs*, 115th Cong. 17 (2018) (Statement of Saule T. Omarova, Prof. of Law, Cornell L. Sch.), *available at* https://www.banking.senate.gov/download/omarova-testimony-and-appendix-91818.

[86] Kapczynski, *supra* note 49, at 1467 ("we need...a more serious engagement with the political economy of data, grounded in the recognition that data is a social relation--an artifact not only of human cognition but also of legal structures.")

[87] Sarah Jeong, The Bitcoin Protocol as Law, and the Politics of a Stateless Currency 9 (Harvard Law Sch., Working Paper, May 8, 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2294124.

[88] TERRI FRIEDLINE, BANKING ON A REVOLUTION: WHY FINANCIAL TECHNOLOGY WON'T SAVE A BROKEN SYSTEM 3 (2020).

"peer-to-peer. But blockchains are not "decentralized" from a constitutional or corporate governance perspective. Even in the bitcoin systems, network participants, known as "miners," gather together blocks of transactions and compete to verify transactions.[89] In return, miners that successfully verify a block of transactions receive newly created cryptocurrency as well any transaction fees that the parties have put on offer.[90] That is to say, there is labor involved, and power dynamics exist between the laborers and others. Moreover, as Pasquale notes, blockchain enthusiasts misleadingly insist on calling that technology "immutable" and "unstoppable"[91] But the parties that validate the "nodes" of blockchain can and have colluded to determine the true identities of transacting parties — or modulate or "fork" the contents of the blockchain. Even the most ostensibly powerless systems still operate based on standards set by private institutions (see, e.g. Ethereum Foundation). Like most distributed ledger technology, the Blockchain is not decentralized in the sense that certain actors cannot exercise concentrated power over others.[92] Moreover, as a general matter, *node validators* in a distributed ledger system can still collaborate to change it.[93] Some blockchains can also take advantage of contextual "off-chain" data, or otherwise collude with third parties to determine the true identities of transacting parties and better monitor their behavior.[94] Network and platform power still permeates the infrastructure, especially in the form of the comparative computing power of participants.

Just as many analysts predicted, the ledger technology that Bitcoin birthed, the blockchain, has now fallen into the same perverse status as cyberspace, which was initially considered as a source of individual freedom.[95] Just as open-source software is fully integrated into Google's Android phones,[96] blockchain is integrated into J.P. Morgan Chase's ledger system.

---

[89] *Id.*
[90] *Id.*
[91] Frank Pasquale, Arthur J. Cockfield, *Beyond Instrumentalism: A Substantivist Perspective on Law, Technology, and the Digital Persona*, 2018 Mich. St. L. Rev. 821, 840 (2018). See also Angela Walch, *The Bitcoin Blockchain as Financial Market Infrastructure: A Consideration of Operational Risk*, 18 N.Y.U. J. LEGIS. & PUB. POL'Y 837, 861 (2015).
[92] *See* Angela Walch, *Deconstructing 'Decentralization': Exploring the Core Claim of Crypto Systems*, *in* CRYPTOASSETS: LEGAL, REGULATORY, AND MONETARY PERSPECTIVES 39, 39-69 (Chris Brummer ed., 2019) (arguing misleading claims of "decentralization" function as a liability shield for developers operating the systems, creating a "Veil of Decentralization").
[93] *See, e.g.*, Angela Walch, *The Path of the Blockchain Lexicon (and the Law)*, 36 REV. BANKING & FIN. L. 713, 735–45 (2017) (discussing various ways in which prominent blockchains have been mutated, most notably the 51% attach).
[94] *See, e.g.*, Rainey Raitman, *In Foreshadowing Cryptocurrency Regulations, U.S. Treasury Secretary Prioritizes Law Enforcement Concerns*, ELECTRONIC FRONTIER FOUND. (Feb. 13, 2020), https://www.eff.org/deeplinks /2020/02/foreshadowing-cryptocurrency-regulations-us-treasury-secretary-prioritizes-law (noting that even pseudonymous wallet systems can still reveal a "huge number" of identities and financial transactions); Gregory Barber, *Everyone Wants Facebook's Libra to Be Regulated. But How?*, WIRED (July 18, 2019), https://www.wired.com/story/Everyone-wants-facebooks-libra-regulated-but-how/ (arguing companies that offer Libra services could use the same tools as law enforcement to re-identify users); Julie E. Cohen, *The Regulatory State in the Information Age*, 17 THEORETICAL INQUIRIES L. 369, 394 (2016) (describing how reidentification creates large unsecured data reservoirs).
[95] Georgios I. Zekos, Economics and Legal Understanding of Virtual Currencies, Banking & Fin. Services Pol'y Rep., August 2019, at 1, 13.
[96] Ron Amadeo, *Google's Iron Grip on Android: Controlling Open Source by Any Means Necessary*, ARS TECHNICA (July 21, 2018, 9:56 AM),

Because it is still ledger technology, blockchain is still used to regulate people's conduct, to make certain that they comply with the law or with the contractual obligations that they have entered into. To that extent, the blockchain can be employed to control identity, making it easier to check or merely keep track of numerous online actions.

Moreover, we should question the general impulse here. Is the freedom crypto seeks simple opposition to control? Powerful actors are already appropriating liberatory language for their own aims. Democracy demands we be able to participate in society without constant fear and apprehension of being watched (or found out). The limited conception of what is "private", as expressed by the third-party doctrine is a form of social control that devastates marginalized communities.[97] We do not want to live in subordinated or subaltern spaces; we want to be ourselves for the world to see. Cryptocurrency may allow us to transact in public without revealing who we are. But we do so under the cover of fear: to "stay inside" -- is not freedom.[98]

Postal Cash & Coin Circulation

The Federal Reserve Act (FRA) expressly sought a more elastic currency, based on the new technology afforded to the banking system, to meet the needs of a rapidly industrializing economy.[99] The Act completed a process begun with "Greenbacks", issuing Federal Reserve notes, rendering paper currency in the United States plentiful, "safe", and circulated at par.[100] The FRA established the Fed that we all know today, and transferred de facto *and* de jure administration of the national money supply from the Comptroller to this new entity.

Although it is the popular belief that merchants are constitutionally required to accept cash,[101] private businesses are not, in fact, mandated by federal statute to accept any type of currency for their goods or services.[102] Because Federal Reserve Notes (and the coins minted by the U.S. Treasury) must only be accepted as legal tender for "debts incurred", per the Constitution, a customer must first establish that they "owed" the relevant merchant, for example, by possessing the purchased item. This custom is heavily rooted in implied-in-fact contract theory and is easily avoided by a merchant simply waiting to provide a good until payment is received.

---

https://arstechnica.com/gadgets/2018/07/googles-iron-grip-on-android-controlling-open-source-by-any-means-necessary [https://perma.cc/9H3D-6F6N].

[97] *See generally* Scott Skinner-Thompson, Privacy at the Margins (2020).

[98] *See* Khiara M. Bridges, The Poverty of Privacy Rights 96 (2017).

[99] Steven A. Ramirez, *The Emergence of Law and Macroeconomics: From Stability to Growth to Human Development*, Law & Contemp. Probs., 2020, at 219, 223.

[100] John Crawford, *Making Money Safe*, 95 Notre Dame L. Rev. Reflection 1, 3 (2019)

[101] Legal Tender Status, U.S. Dep't of the Treasury, https://www.treasury.gov/resource-center/faqs/Currency/Pages/legal-tender.aspx [https://perma.cc/2R4J-FZML] (last updated Jan. 4, 2011, 4:47 PM).

[102] Is It Legal for a Business in the United States to Refuse Cash as a Form of Payment?, Board of Governors of the Fed. Res. Sys. [hereinafter Is It Legal to Refuse Cash?], https://www.federalreserve.gov/faqs/currency_12772.htm [https://perma.cc/4Z8G-YHFT] (last updated June 17, 2011) ("There is ... no Federal statute mandating that a private business, a person, or an organization must accept currency or coins as payment for goods or services.").

Among a list of ten security systems design principles offered by the Berkman Klein Center for Internet and Society, the very first is minimizing data collection, period. Yale University security expert Bruce Schneier stresses that we also need to start disconnecting systems, quickly, to prevent an insecure free-for-all throughout the IoT.[103] If we cannot build secure systems, we should think twice about engineering the interconnected surveillance that renders insecurity.[104] Preserving a place for cash also helps with operational security as digital systems can be compromised by failure or hacking.[105]

Online data should be encrypted wherever possible. As the crypto community has demonstrated, it is the single best security feature for the Internet Age.[106] But re-embracing the analog is a more basic solution for payment systems. We must increase the general circulation of cash and coins products, as the COVID-19 payments crises showed. Banks, partially by statute and partially by convention, are currently in charge of most cash and coin circulation and prohibit non-customers from making change at their branch locations. During the pandemic, this has meant unbanked people have not been able to for instance, wash clothes or purchase food from a vending machine on the job. Coin circulation problems inevitably link to cash circulation problems. Some retailers are adjusting by offering consumers loyalty points,[107] donations to charity, or other alternatives. But more importantly a number retailers have simply shied away from accepting cash payments.

In order to streamline cash and coin circulation and redemption, we should look to Treasury and its broader attachments. There is no constitutional requirement that all forms of cash or coins must enter broader commerce through the Federal Reserve System, much less the commercial banking system.[108] Indeed, even though the Federal Reserve "issues cash", new currency designed and printed by the Treasury's Bureau of Engraving and Printing, new coins are minted by the Mint, and most all circulation is achieved via the commercial banking system.

A strong defense of cash would be to partner with the U.S. Postal Service for cash and coin circulation. Long before the telegraph, broadcast radio and television, and the internet, the post office was an essential system for mass communication among American citizens.[109]

---

[103] *See generally* BRUCE SCHNEIER, "CLICK HERE TO KILL EVERYBODY" (2018) (hereinafter CLICK HERE).
[104] *Id.* at 167-170
[105] Hilary J. Allen, *Payments Failure*, 62 B.C. L. Rev. 453, 454, 513 (2021)
[106] Encrypting computer devices and communications, including payments, is not a panacea. Encrypted data can still be decrypted and backdoors obviate many of the advantages of encryption, generally. Breaches and invasions of privacy can still occur if the spy has log-in credentials. Metadata cannot be encrypted.
[107] https://www.latimes.com/business/story/2020-07-30/coin-shortage-quarters-change
[108] See Philip N. Diehl, Why Don't the Banks Pass the Buck?, Wash. Post, Sept. 2, 2000, at A25 (noting that banks do not have exclusive rights to new coins). *See Policies: The Federal Reserve in the Payments System*, Bd. of Governors Fed. Rsrv. Sys., https://www.federalreserve.gov/paymentsystems/pfs_frpaysys.htm [https://perma.cc/XWM6-VQ7H].
[109] *See* Winifred Gallagher, How the Post Office Created America: A History 1, 5 (2016); Richard R. John, Spreading the News: The American Postal System from Franklin to Morse vii (1995); Anuj C. Desai, *The Transformation of Statutes into Constitutional Law: How Early Post Office Policy Shaped Modern First Amendment Doctrine*, 58 Hastings L.J. 671-73, 676 (2007). From 1911 to 1967, the US Postal Service ran a Postal Savings Bank. Importantly, however, this was not integrated into the broader payment systems. See generally Act of June 25, 1910, 36 Stat 814, repealed by Act of Mar 28, 1966, Pub L No 89-377, 80 Stat 92. Democratic presidential candidate Bernie Sanders has called for the revival of postal banking. See *Text of Bernie Sanders' Wall Street and*

Baradaran, the APWU, and many policymakers argued for "postal banking" for some time.[110] Postal banks would offer a free savings and checking account that would enable the unbanked and underbanked to engage in simple financial transactions instead of high cost non-bank options like check-cashing or prepaid debit cards.[111] This should be complemented with a demand for "postal payments" more broadly, including the ability to store paper cash and coins at the post office and for USPS to aid in cash & coin circulation. It should comfort those worried about security that USPS is also subject to the BSA-AML regime, even if cash will lessen the intensity of its application.[112]

Public Banking, Postal Banking, Central Bank Digital Currency, Fed Accounts, E-Cash Wallets, & Postal Payments

Congress should explore the creation of a full-fledged digital public payments & banking system, bolstering the existing authority of USPS and other federal agencies. An increasingly large group of legal scholars advocating that we offer a ledger-based system to everyone via public option.[113] The Federal Reserve Board should be commended on its decision to establish and implement FedNow, a new interbank 24x7x365 real-time gross settlement (RTGS) system to facilitate real-time payments (RTP) between financial institutions of all sizes.[114]

Economy Speech (MarketWatch, Jan 5, 2016), archived at http://perma.cc/PMM6-NWMW. Adam J. Levitin, *Safe Banking: Finance and Democracy*, 83 U. Chi. L. Rev. 357, 380 (2016)

[110] *See, e.g.,* Mehrsa Baradaran, *It's Time for Postal Banking*, 127 Harv. L. Rev. F. 165 (2014). "The Post Office or any public banking option must learn to adapt existing modern technology to offer fair, useful, and self-sustaining products to those neglected by mainstream banks." Mehrsa Baradaran, *Credit, Morality, and the Small-Dollar Loan*, 55 Harv. C.R.-C.L. L. Rev. 63, 126–27 (2020)

[111] *See* Campaign for Postal Banking, Postal Banking: Know the Facts, http://www.campaignforpostalbanking.org/wp-content/uploads/2015/05/KnowtheFacts.pdf [https://perma.cc/TBA8-YUXG].

[112] 31 C.F.R. §1010.100(ff).

[113] See, e.g. Morgan Ricks, John Crawford, and Lev Menand, *FedAccounts: Digital Dollars*, 89 George Wash. L. Rev. 113 (2020); Robert Hockett, *Digital Greenbacks: A Sequenced 'TreasuryDirect' and 'FedWallet' Plan for the Democratic Digital Dollar*, 25 J. of Tech. L. & Pol. (2020). Professor Hockett's plan for an "Inclusive Value Ledger" bears some technical, but little substantive similarity to the plan discussed in this Part. Ledger systems are not "peer-to-peer" by their very definition. Hockett's idea for a "digital dollar", influenced by Comm. Giancarlo and others, actually manifests via reinforcement of the already existing ledger of Treasury Direct Accounts (TDAs), used for securities transactions. Adding horizontal connectivity between the accounts Hockett misleadingly refers to as "wallets" does not mean vertical connectivity with the state disappears or is even mitigated. The Treasury obviously still intermediates all transactions and it is not clear what payments data the IRS or FinCen can collect. Indeed for Hockett, the IVL's ability to enhance tax collection, AML, CFT, and sanctions law is somehow characterized as a privacy **feature** of the system. Hockett also states that transactions on the ledger will be subject to Fourth Amendment protections, but provides no Fourth Amendment analysis.

[114] *See* Letter from AFR Education Fund & DPEF to Board (2019) https://www.federalreserve.gov/SECRS/2019/December/20191230/OP-1670/OP-1670_110719_136983_394241172069_1.pdf. *See also* Comment from FTC Comm'r Rohit Chopra to FTC (Nov. 7, 2019), https://www.ftc.gov/public-statements/2019/11/comment-commissioner-rohit-chopra-federal-reserve-proposal-develop-round (urging the Board to proceed promptly, arguing that slow development has created space for the Libra project and "attempts to bypass our banking system altogether.")

We should also have public banking accounts. Currently, we are forced to rely on the banks as middlemen to deliver government assistance. Some of them have even seized emergency COVID-19 payments to collect debts.[115] Some experts have called for Silicon Valley firms to partner with the government on this endeavor.[116] But Big Tech's involvement in public money development would doom any future financial privacy in public.[117] A new "digital dollar" should respect the privacy of its users.[118] Such respect would entail, among other features, taking a queue from the crypto community and offering digital *wallets* as well as *bank accounts*.[119]

Herein the legal and technical expertise of Professor Rohan Grey at Willamette School of Law, who also serves as Privacy Lead at the International Telecommunications Union -- wherein they have been discussing the relationship between privacy and evolving communications infrastructure for decades -- is especially indispensable. Professor Grey was the first legal scholar to emphasize the imperative of preserving "bearer instruments" in a digital transformation. As Grey argues, the terms "central bank digital currency", "digital dollar", and "e-cash" are often conflated. This is unhelpful: a 'digital dollar' may be issued by any agency of the U.S. government, while a CBDC, by definition, must be issued by the Central Bank. While some blockchains may blur the lines between these categories, none provide true peer-to-peer, offline

---

[115] *See* Press Release, U.S. S. Comm. on Banking, Hous., and Urban Affairs, *Brown, Warren Call On Banks To End The Seizure Of Stimulus Checks* (Apr. 15, 2020), *available at* https://www.banking.senate.gov/newsroom/minority/brown-warren-call-on-banks-to-end-the-seizure-of-stimulus-checks.

[116] *See, e.g., The Digitization of Money and Payments: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs,* 116th Cong. 7-10 (2020) (Statement of Hon. J. Christopher Giancarlo, Chair Emeritus, CFTC), *available at* https://www.banking.senate.gov/download/giancarlo-testimony-6-30-20&download=1.

[117] As would Wall Street's involvement. *See, e.g.,* Raúl Carrillo, *Postal Banking: Brought to you by JP Morgan Chase?*, Take on Wall St. Blog (Aug. 27, 2020), https://takeonwallst.com/2020/08/postal-banking-jp-morgan-chase/.

[118] *See, e.g.*, Jason Brett, *Congress Considers Federal Crypto Regulators In New Cryptocurrency Act Of 2020*, Forbes (Dec. 19, 2019), https://www.forbes.com/sites/jasonbrett/2019/12/19/congress-considers-federal-crypto-regulators-in-new-cryptocurrency-act-of-2020/#716eff165fcd (describing the popularization of the idea of the digital dollar in response to Libra's development).

[119] David Beckworth & Rohan Grey, *The Future of Digital Currency*, Mercatus Center Blog (Feb. 11, 2019), https://www.mercatus.org/bridge/podcasts/02112019/future-digital-fiat-currency, Rohan Grey (2019), Banking in a Digital Fiat Currency Regime, in Philipp Hacker et al (eds.), *Regulating Blockchain: Techno-Social and Legal Challenges.*; Jonathan Dharmapalan & Rohan Grey, The Case for Digital Legal Tender: The Macroeconomic Policy Implications of Digital Fiat Currency, eCurrency Mint Ltd. (2018), https://www.ecurrency.net/static/resources/201802/TheMacroeconomicImplicationsOfDigitalFiatCurrencyEVersion.pdf.

transactions like e-Cash in the ABC Act sponsored by Rep. Tlaib (D-MI)[120] or the model currently being considered by the Bank of Canada.[121]

While legal firewalls might prevent some level of abuse in an account-based system, technological solutions are necessary. If the owner of a public centralized ledger system, (for instance, the Federal Reserve Bank of New York) were able to access digital dollar transaction activity at any given time, that data could be inappropriately accessed by other governmental entities, including law enforcement.[122] By contrast, within our existing monetary system, the Federal Reserve System does not make any records of where individual Federal Reserve Notes are at any given time; circulation is merely recorded as a single aggregate liability on the Fed's balance sheet titled 'Federal Reserve Notes Outstanding.'[123]

A new public system for payments should proceed from the principle that data that is not harvested in the first place cannot be abused. In some sense, maintaining a place for cash can even be characterized as "conservative" of our best traditions. In order to mitigate illicit flows, policymakers could choose to only offer anonymity under a certain threshold of holdings, as federal law does now with paper cash.[124] Cash has security techniques, most notably the barcode. A number of public features enable people to visually inspect and verify the authenticity of each bill. For example, the U.S. The Bureau of Printing and Engraving publishes details about some of the features of new U.S. dollars, such as color-shifting ink, a new watermark, a metallic security thread, and the use of micro print.[1] Privacy and public sector innovation need not conflict.

Herein, we can learn something from the crypto community's deployment of cryptographically-verifiable electronic tokens. Assuming the security of the cryptographic mechanisms and the secrecy of the associated cryptographic information are preserved, digital

[120] Critically, Rep. Tlaib's ABC Act asks the Treasury to offer recipients the option to receive payments via FedAccounts *or prepaid debit cards*, which in the future would be loaded with funds via an eCash wallet instead of connected to a regular commercial bank account via TreasuryExpress. This vision – of disseminating relief payments via a pre-loaded 'cash card,' while avoiding any need for individuals to register for an account that could be monitored or tracked, was a critical design feature of the bill and one of the major differentiating features between it and other FedAccount proposals, which risk discriminating against undocumented people who may not be able to open an account. The digital dollar 'eCash' wallets would be capable of being self-hosted by any person in possession of a cheap, handheld device, regardless of residency status, just like cash today. https://tlaib.house.gov/media/press-releases/tlaib-jayapal-introduce-groundbreaking-bill-deliver-universal-recurring-0

[121] https://www.bankofcanada.ca/2020/06/staff-analytical-note-2020-10/.

[122] *See, e.g.*, Matla Garcia Chavolla, *Cashless Societies and the Rise of the Independent Cryptocurrencies: How Governments Can Use Privacy Laws to Compete with Independent Cryptocurrencies*, 31 PACE INT'L L. REV. 263, 273 (2018).

[123] *See* Rohan Grey, *Administering Money: Coinage, Debt Crises, and the Future of Fiscal Policy*, KY. L.J. 1, 16-18 (forthcoming 2020), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3536440.

[124] *See* Marco Dell'Erba, *Stablecoins in Cryptoeconomics: From Initial Coin Offerings to Central Bank Digital Currencies,* 22 N.Y.U. J. LEGIS. & PUB. POL'Y 1, 43 (2020). However, *see also*, Jason Leopold et al., *The FinCEN Files*, BUZZFEED (Sept. 20, 2020), https://www.buzzfeednews.com/article/jasonleopold/fincen-files-financial-scandal-criminal-networks (arguing the post-9/11 AML, CFT, and sanctions regime, in addition to violating civil rights, does not work as purported. Surveillance has not necessarily led to increased law enforcement).

cash cannot be counterfeited.[125] More decentralized verification attempts to achieve security by enabling individuals (or their digital wallet) to perform real-time validation of bills they receive. QR codes can also help prevent counterfeiting.[126]

Wallets are also especially important to privacy and security for doctrinal reasons: creating a password-protected account to store information is comparable to storing papers in a lock box where only the owner has the key.[127] Historically, wallets, as well as paper receipts, checkbooks, and wallets have been deemed "closed containers" and sometimes provided with Fourth Amendment protections.

Surveillance must be centered within any discussion of a public option for financial services. FDIC surveys consistently note that many "unbanked" households refuse to open bank accounts due to privacy concerns.[128] While providing increased access to digital financial services is important, a rapid shift to digitization stands to harm low-income people of color in particular.[129] Many current proposals for a public system center round a certain technological infrastructure (like universal *quality* broadband),[130] not to mention a certain level of household financial stability.

There are limits to what a reconstruction of the payments architecture can accomplish; many poor people have no privacy regardless.[131] What the proliferation of cash and e-cash accomplishes is at once more subtle and more impactful. It removes the possibility of certain data being collected *in the first place*. Where bearer-instruments replace ledger-instruments, they decrease surveillance. Cash -- and financial privacy in general -- deserve priority in our evolving digital systems.

---

[125] Nicolas Christin et. al., *Monetary Forgery in the Digital Age: Will Physical-Digital Cash Be A Solution?*, 7 I/S: J.L. & Pol'y for Info. Soc'y 171, 173–75 (2012)

[126] Beckworth & Grey. https://www.mercatus.org/bridge/podcasts/02112019/future-digital-fiat-currency

[127] *See* David D. Thomas, *Dangerously Sidestepping the Fourth Amendment: How Courts Are Allowing Third-Party Consent to Bypass Warrants for Searching PasswordProtected Computer*, 57 CLEV. ST. L. REV. 279 (2009).

[128] FDIC, National Survey of Unbanked and Underbanked Households, 2017 4, 23-24, https://www.fdic.gov/householdsurvey/. *See also, id.* at 3 (noting Black households are nearly six times more likely to be unbanked than white households, while Hispanic households are nearly five times more likely to be unbanked than white households).

[129] Jay Stanley, *Say No to the "Cashless Future" — and to Cashless Stores*, ACLU (Aug. 12, 2019), https://www.aclu.org/blog/privacy-technology/consumer-privacy/say-no-cashless-future-and-cashless-stores.

[130] *See, e.g.*, Terri Friedline, *An Open Internet is Essential for Financial Inclusion, FinTech Revolution*, Huff. Post (Dec. 14, 2017), https://www.huffpost.com/entry/an-open-internet-is-essential-for-financial-inclusion_b_5a3345dce4b0e1b4472ae520.

[131] Bridges, *supra* note 98, at 67.

Hearing on
"Banking Innovation or Regulation Evasion?:
Exploring Modern Trends in Financial Institution Charters"
Before the U.S. House of Representatives Committee on Financial Services,
Subcommittee on Consumer Protection and Financial Institutions

Thursday, April 15, 2021, 10 a.m. (Eastern)

Prepared Statement of
Erik F. Gerding
Professor of Law and Wolf-Nichol Fellow
University of Colorado Law School

Executive Summary

From 2018 to 2020, the FDIC and OCC embarked on a series of power grabs that conferred the powers and privileges of banks on nonbank commercial firms.

The 2020 FDIC reopening of deposit insurance to industrial loan companies ("ILCs") threatens to:

- ¶ create risks to financial stability;
- ¶ distort competition in commercial markets;
- ¶ distort competition in banking markets and promote greater risk-taking;
- ¶ generate conflicts of interest in lending; and
- ¶ compromise consumer protections.

The FDIC's ability to map and respond to these risks is limited by the fact that ILCs and the conglomerates that own them are not subject to consolidated supervision.

The OCC's new fintech charter contravenes the text, purpose, and structure of the National Bank Act and other core federal banking statutes. Conferring banking privileges on non-deposit taking firms provides them with competitive advantages over commercial rivals that distorts markets. The OCC's fintech charter seems designed mainly to preempt state financial laws without authorization from Congress. It would also open up exemptions from important federal financial laws for favored firms.

Congress should reverse these dangerous power grabs and close destructive loopholes in banking law by:

- ¶ ending the ILC exemption to the Bank Holding Company; and
- ¶ removing the Comptroller's ability to issue future charters to non-deposit taking firms.

Congress should reinforce the walls separating commerce from banking, which:

- ¶ guard against concentrations of financial, economic, and political power in the largest banking, retail, and tech conglomerates;
- ¶ prevent distortions and unfair competition in commercial markets;
- ¶ safeguard financial stability;
- ¶ reduce conflicts of interest in credit; and
- ¶ protect consumers.

These walls also prevent bank regulators from gaining unprecedented oversight power over vast swaths of American commerce. Without these walls, much of financial services and commerce could come to be dominated by Big Wall Street, Big Retail, and Big Tech conglomerates.

Mr. Chairman Perlmutter, Ranking Member Luetkemeyer, and Members of the Committee:

Thank you for inviting me to testify at today's hearing on "Banking Innovation or Regulation Evasion?: Exploring Modern Trends in Financial Institution Charters."

My testimony today will focus on actions taken by the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation from 2018 through the end of the Trump Administration to confer certain privileges and powers of banks on non-bank firms. I will discuss how these actions eroded the separation of banking and commerce, which is foundational to American banking law. I will also explain why this erosion creates grave concerns for:

¶ concentrating financial, economic, and political power;

¶ financial stability;

¶ consumer protection; and

¶ distorted competition both in non-banking and banking markets.

I am a law professor at the University of Colorado Law School. My teaching and research focus on banking and securities regulations. I have authored numerous articles on banking and securities laws, and financial crises. Much of my research focuses on the "shadow banking system," which describes a network of nonbank intermediaries that perform the same economic functions as banks, generate the same risks of financial crises as banks, but are not subject to the same regulations as banks.[1] I am also the co-author of a treatise on payment systems.[2]

Before joining the faculty at the University of Colorado, I was on the faculty of the University of New Mexico School of Law and served as a visiting professor at the University of Georgia School of Law. Before becoming an academic, I practiced for eight years at Cleary, Gottlieb, Steen, and Hamilton.

I have not received any Federal grants or any compensation in connection with this testimony, and I am not testifying on behalf of the University of Colorado or any other organization. The views expressed in my testimony are solely my own.

I. Overview

Over the past four years and accelerating in the last year of the Trump Administrative, the Office of the Comptroller of the Currency (the "OCC") and the Federal Deposit Insurance Corporation ("FDIC") took a series of dramatic actions to confer certain privileges and powers of federally regulated banks on non-bank firms. The most dramatic of these agency moves were the following:

---

1 *E.g.*, ERIK F. GERDING, LAW, BUBBLES, AND FINANCIAL REGULATION, pt. IV (2014).

2 ERIK F. GERDING, NEGOTIABLE INSTRUMENTS UNDER THE U.C.C. (Bender). Professors Fred Hart and William Willier were the creators of this treatise.

¶ The OCC's invention of a "fintech charter" for non-banks in 2018[3] and its processing of applications for these charters starting in the summer of 2020[4] despite an order from a federal judge ruling that the OCC had exceeded its statutory authority[5] and an appeal in front of the U.S Court of Appeals for the Second Circuit;[6] and

¶ The FDIC both:

- ending a long moratorium and granted new applications for FDIC deposit insurance to industrial loan companies ("ILCs"), and
- issuing new rules to pave the way for more new ILCs.[7]

These regulatory actions combined with other 2020 actions by the two agencies that allowed banks to transfer immunities from state usury and consumer laws to nonbanks.[8] This is but a small sample of the wave of deregulatory actions taken by the OCC and FDIC in 2020 while the public and Congress were preoccupied with the pandemic and its economic fallout. Much of this deregulation benefitted nonbanks.[9]

---

3 Office of the Comptroller of the Currency, Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters (July 31, 2018) *available at* https://www.occ.gov/news-issuances/news-releases/2018/pub-other-occ-policy-statement-fintech.pdf (last visited Apr. 8, 2021); Office of the Comptroller of the Currency, Comptroller's Licensing Manual Supplement: Considering Charter Applications From Financial Technology Companies (July 2018) *available at* https://www.occ.gov/publications-and-resources/publications/comptrollers-licensing-manual/files/considering-charter-apps-from-fin-tech-companies.html (last visited Apr. 8, 2021).

4 Victoria Guida, *Top Regulator Pushes Ahead with Plan to Reshape Banking, Sparking Clash with States*, Politico (Aug. 31, 2020) *available at* https://www.politico.com/news/2020/08/31/currency-comptroller-reshape-banking-406393 (last visited Apr. 8, 2021).

5 Vullo v. Office of the Comptroller of the Currency, 378 F. Supp. 3d 271 (S.D.N.Y. 2019).

6 Lacewell v. Office of the Comptroller of the Currency, 19-4271-cv (2d.Cir.).

I was one of the signatories of an *amicus* brief supporting the district court opinion and opposing the OCC fintech charter. Brief of Thirty-three Banking Law Scholars as *Amici Curiae* in Support of Appellee in Lacewell v. Office of the Comptroller of the Currency, 19-4271-cv (2d.Cir.) *available at* https://justmoney.org/wp-content/uploads/2020/08/19-4271-Amicus-Brief-of-Banking-Law-Scholars.pdf (last visited Apr. 8, 2021) [hereinafter *Brief of Thirty-three Banking Law Scholars*].

7 FDIC final rule, "Parent Companies of Industrial Banks and Industrial Loan Companies," 86 Fed. Reg. 10,703 (Feb. 23, 2021) *available at* https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-b-fr.pdf (last visited April 7, 2021).

8 OCC final rule, "National Banks and Federal Savings Associations as Lenders," 85 Fed. Reg. 68,742 (Oct. 30, 2020) ("OCC True Lender rule"); OCC final rule, "Permissible Interest on Loans That Are Sold, Assigned or Otherwise Transferred," 85 Fed. Reg. 33,530 (June 2, 2020) ("OCC Usury Preemption Transfer Rule"); FDIC final rule, "Federal Interest Rate Authority," 85 Fed. Reg. 44,146 (July 22, 2020) ("FDIC Usury Preemption Transfer Rule").

9 For example, in December 2020, the FDIC also issued a final rule allowing fintech and other firms to partner with national banks to provide them with deposits without triggering the restrictions of brokered deposit rules. This rule benefits both fintech firms that seek to supply banks with deposits and banks that would be otherwise precluded from accepting these sources of financing. The FDIC rule loosens requirements that Congress first created in the wake of the 1980s savings and loan crisis to restrict brokered deposits. FDIC final rule, "Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate

Individually and together, these OCC and FDIC actions dramatically increased the ability of non-banks to enjoy the privileges and powers of federally regulated banks. These OCC and FDIC actions thus eroded the separation between banking and commerce that has been foundational to American banking law. Separating banking and commerce has numerous purposes, including guarding against excessive concentrations of financial, economic, and political power. Eroding the separation between banking and commerce poses risks to financial stability and consumer protection and threatens to:

¶ distort non-financial markets by allowing commercial firms that can obtain bank powers and privileges to compete unfairly with firms that cannot,

¶ distort banking markets by allowing non-banks to offer banking services without facing the same degree of supervision and regulation as banks, *which in turn would*,

¶ create incentives for banks to take more risk or lobby for deregulation.

The FDIC's reopening of ILC applications and access to federal deposit insurance and the OCC's fintech charter represent power grabs by federal bank regulators that could give them oversight over a vast domain of non-bank financial services and even non-financial commercial activity. Not only are the FDIC and OCC ill-equipped to conduct this oversight, the expansion of their oversight into realms of commerce and traditional provinces of state law would give them power far beyond what Congress intended.

It is not clear that these OCC and FDIC actions would result in the positive effects cited by their architects. There are indeed deep and unmet market and community needs to which banks or fintech companies can respond. However, rather than the "Pandora charters" promoted by the FDIC and OCC, Congress and regulators should explore other measures to meet these needs. The Pandora charters undermine fundamental public policies and threaten to further entrench the largest commercial firms at the expense of smaller commercial firms and community banks.

Among the immediate steps I recommend below are the following:

¶ Congress should end the ILC exemption to the Bank Holding Company Act. I therefore support the "Close the ILC Loophole Act" being considered by this Subcommittee;

¶ If ending the ILC exemption now is infeasible, I support a long moratorium on the FDIC approving deposit insurance. I therefore support the Bank Charter Review Act should the Close the ILC Loophole Act not pass; and

---

Restrictions," 86 Fed Reg. 6,742 (Jan. 22, 2021) ("FDIC Brokered Deposit Rule"). Brokered deposits present more liquidity risks to banks that traditional deposits because depositors may be more likely to move money in a brokered deposit to another bank. Congress's concern was that troubled banks might use brokered deposits to fund risky investments and that depositors switching to other banks could more easily precipitate a bank run. Congressional Research Service, FDIC Proposes Changes to Brokered Deposit Regulation (Jan. 6, 2020) *available at* https://crsreports.congress.gov/product/pdf/IN/IN11209 (last visited Apr. 12, 2021).

¶ Although I believe federal courts will strike down the OCC fintech charter, to prevent adventurism by future Comptrollers, Congress should amend the National Bank Act to prohibit any future OCC charters of non-deposit taking firms.

The remainder of this report proceeds as follows:

¶ Part II examines the FDIC move to reopen deposit insurance for new ILCs;
¶ Part III examines the OCC fintech charter;
¶ Part IV explains the reasons that Congress has long separated banking and commerce;
¶ Part V discusses the institutional problems when Congress undermines clear categories of financial institution charters;
¶ Part VI sets forth first principles for proper roles for state regulators;
¶ Part VII lays out my recommendations for more immediate action by Congress;
¶ Part VIII argues for alternative, longer term approaches to the banking needs of underserved communities; and
¶ Part IX outlines several issues adjacent to nonbank bank charters for future consideration by this Subcommittee.

II. FDIC Reopens Deposit Insurance to ILCs in 2020

In 2020, the FDIC began approving applications for FDIC deposit insurance to new ILCs. This ended a long moratorium, which lasted over a decade, which was imposed first by prior FDIC leadership and later by the Dodd-Frank Act. This moratorium followed the controversy when Walmart sought to create an FDIC-insured ILC in 2005 and 2006.[10]

In December 2020, the FDIC issued a final rule[11] setting forth the conditions it will impose and the commitments it will require from ILCs to receive deposit insurance from the agency. The financial and legal communities see this as a major development that paves the way for more non-bank firms – including not just specialized "fintech" firms, but also large tech and platform companies like Amazon and retail conglomerates – to own ILCs and gain access to federal deposit insurance.[12]

In 2020, the FDIC began accepting applications from new ILCs for deposit insurance. The agency granted deposit insurance to two ILCs, one owned by the payments company Square and another by Nelnet, a financial conglomerate focused on student loans. Other companies, including

---

10 For an analysis of the Walmart controversy, see Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539 (2007).
11 *Supra* note 7.
12 *E.g.*, Jesse Hamilton, *Could Amazon Start a Bank? The FDIC has Opened the Door*, CHICAGO TRIB. (Dec. 16, 2020) *available at* https://www.chicagotribune.com/business/ct-biz-amazon-facebook-bank-loans-fdic-20201216-bd2glh3nlzbxxlevrxeiwg43n4-story.html (last visited Apr. 7, 2020); Scott A. Coleman & James Kim, "FDIC Issues Final Rule on ILC Deposit Insurance Applications," BallardSpahr LLP Consumer Finance Monitor (Dec. 28, 2020) *available at* https://www.consumerfinancemonitor.com/2020/12/28/fdic-issues-final-rule-on-ilc-deposit-insurance-applications/ (last visited Apr. 7, 2021).

the giant Japanese online retailer Rakuten (called the "Amazon of Japan"), are in various stages of the FDIC application process.[13]

After providing some history and background of ILCs, I examine below how the ILC exemption to the Bank Holding Company Act:

- ¶ Poses threats to financial stability;
- ¶ Creates an uneven playing field among commercial firms;
- ¶ Creates potential conflicts of interest in lending;
- ¶ Distorts banking markets; and
- ¶ Creates potential for abuses of consumers.

Regulators cannot adequately detect or counter these threats because ILCs and the conglomerates that own them are not subject to consolidated supervision.

A. History/Background on ILCs

Modern ILCs scantly resemble their progenitors, Morris Plan banks, which were small early 20th century lending institutions designed to provide credit to industrial workers who were not served by established depository banks.[14] ILCs have become FDIC-insured financial institutions, some of which are quite large and have expansive and complex nationwide operations. Some ILCs have engaged in subprime lending and securitization activities.[15]

Thanks to a 1987 amendment to the Bank Holding Company Act, ILCs are exempt from the definition of "bank." This exemption has several significant consequences including the following:

> *ILCs are exempt from restrictions that separate banking from commerce:* The Bank Holding Company Act generally prohibits commercial firms from owning banks and banks from owning commercial enterprises;[16]

---

13 Brendan Pedersen, *Rakuten Mounts Third Attempt for Industrial Bank Charter*, AMER. BANKER (Jan. 19, 2021) *available at* https://www.americanbanker.com/news/rakuten-mounts-third-attempt-for-industrial-bank-charter (last visited Apr. 11, 2021); Wilmarth, *The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks*, 39 BANKING & FIN. SVCS. Pol'y Rep. No. 5 at 1-2 (May 2020) *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3613022 (last visited Apr. 11, 2021).

14 For a history of Morris Plan Banks, see MEHRSA BARADARAN, HOW THE OTHER HALF BANKS: EXCLUSION, EXPLOITATION, AND THE THREAT TO DEMOCRACY 94-99 (2015).

15 *See* Wilmarth, *The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks*, *supra* note 13, at 6.

16 Saule T. Omarova & Margaret E. Tahyar, *That Which We Call a Bank: Revisiting the History of Bank Holding Company Regulations in the United States*, 31 REV. BANKING & FIN. L. 113, 119, 159-160 (2011-2012).

> *ILCs fall outside Federal Reserve consolidated supervision:* Unlike banks, the Federal Reserve cannot exercise consolidated supervision over ILCs, nor can it impose capital requirements on ILCs.[17]

I discuss the important difference between *consolidated* supervision of an entire conglomerate versus ordinary supervision of a single financial institution entity in more detail below.

These exemptions mean that regulatory and supervisory duties fall primarily on the FDIC and the state regulator that charters an ILC.[18] Utah has chartered most existing ILCs, with a half dozen other states either having chartered an ILC or having statutes that authorize this type of charter.[19]

The Industry Transforms After the 1987 Bank Holding Company Act

ILCs first became eligible for federal deposit insurance in 1982. When Congress amended the Bank Holding Company Act of 1987, ILCs were still "small locally-focused institutions that offered deposit and credit services to lower- and middle-income consumers."[20] At that moment, ILCs held a combined $4.2 billion in assets, with the largest ILC having assets of $420 million.[21] In 1993, the Congressional Research Service found that ILCs remained minor to the entire U.S. financial system.[22] However, two developments in the 2000s marked the massive transformation of ILCs into significant parts of American finance: the application of Walmart for an ILC charter in 2005 and the global financial crisis in 2007 and 2008.

The Walmart Storm

Walmart's 2005 application for a Utah ILC license and ultimate FDIC insurance ignited a political and legal firestorm. The Walmart controversy previewed many of the concerns that apply to the FDIC's current reopening of ILC applications. Compared to the original small, local nonbank banks, ILCs owned by large commercial conglomerates posed more significant risks to financial stability and the FDIC's insurance fund, to fair competition with commercial firms without nonbank banking licenses, and to the risk-taking within the regulated banking sector.[23] Ultimately, Walmart withdrew its application, and the FDIC under Chair Sheila Bair imposed the start of a moratorium on new ILC applications for deposit insurance.[24]

---

[17] GENERAL ACCOUNTING OFFICE, CHARACTERISTICS AND REGULATION OF EXEMPT INSTITUTIONS AND THE IMPLICATIONS OF REMOVING THE EXEMPTIONS at 19 (Jan. 19, 2012) *available at* https://www.gao.gov/assets/gao-12-160.pdf at 12, 24-25 (last visited Apr. 10, 2021) [hereinafter *GAO 2012 Report*].

[18] For the historical evolution of ILCs via federal statutes, state chartering of ILCs, and FDIC insurance, see Omarova & Tahyar, *That Which We Call a Bank*, *supra* note 16, at 158-163.

[19] Congressional Research Service, Industrial Loan Companies (ILCs): Background and Policy Issues at 2-3 (Sept. 9, 2020).

[20] *See* Wilmarth, *The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks*, *supra* note 13, at 2.

[21] *Id.*

[22] *Id.*

[23] *See* Wilmarth, *Wal-Mart and the Separation of Banking and Commerce*, *supra* note 10.

[24] Jonathan Birchall, *FDIC Declares Moratorium on Wal-Mart Bank*, FIN. TIMES (July 28, 2006) *available at* https://www.ft.com/content/52f38e24-1e75-11db-9877-0000779e2340 (last visited April 13, 2021).

ILCs in the 2008 Financial Crisis

The size and importance of modern ILCs to the financial system became more than just theoretical with the eruption of the global financial crisis in 2007 and 2008. Indeed, the crisis revealed the threats that ILCs pose to financial stability and to the FDIC's fund. In the global financial crisis, many parent companies did not serve as "sources of strength" for the ILCs that they owned. To the contrary, many prominent nonbank financial firms that owned ILCs failed or required substantial government assistance to remain afloat. The following chart summarizes the crisis fate of six prominent corporate owners of ILCs:[25]

Owner of ILC	Fate during 2008 Financial Crisis
CIT Group	Filed for bankruptcy in November 2009; Federal government suffers total loss of emergency investment.
GE Capital Corporation	Federal Reserve purchases $16 billion of GE Capital commercial paper; FDIC guarantees $70 billion of newly issued debt securities.
General Motors Acceptance Corporation (GMAC)	Emergency conversion into bank holding company; $40 billion in governmental financial assistance in form of TARP equity investments, FDIC debt guarantees, Federal Reserve purchases of commercial paper and loans.
Goldman Sachs	Emergency conversion into bank holding company; TARP capital infusions; FDIC debt guarantees; Federal Reserve purchases of commercial paper and emergency loans.
Merrill Lynch	Government backstop to Bank America to induce emergency purchase of Merrill Lynch in September 2008; TARP equity investments, government asset and debt guarantees, Federal Reserve purchases of commercial papers and emergency loans to support Bank of America and Merrill Lynch.
Morgan Stanley	Emergency conversion into bank holding company; TARP capital infusions; FDIC debt guarantees; Federal Reserve purchases of commercial paper and emergency loans.

Scholars have concluded that the five firms above that survived the 2008 global financial crisis would have failed but for the extraordinary government support they received.[26]

The costs that ILCs imposed on the FDIC and federal government generally did not stop there. Other, less famous, ILC parents also went bankrupt or survived only because of emergency government interventions. For example, Fremont General filed for bankruptcy in June 2007 (after the FDIC ordered it in the prior year to cease subprime mortgage lending). Fremont General's ILC

[25] *See* Wilmarth, *The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks*, *supra* note 13, at 4-6.
[26] *E.g.*, *id.*

assets were the subject of any emergency sale to a newly formed ILC.[27] Prior to the financial crisis, many owners exploited their ILCs FDIC-insured deposits to support their operations. For example, Merrill Lynch offered customers "sweep accounts" to transfer funds from uninsured accounts to FDIC-insured ones, increasing the potential risk to the FDIC insurance fund.[28] Two scholars described how securities firms owning ILCs used this kind of practice to support their securities businesses:

> This allowed securities firms, in effect, to get cheaper financing of their activities and to develop formidable in-house lending capability to support their traditional securities underwriting and dealing and investment advice business. Ownership of ILCs allowed securities firms to become a one-stop-shop for all of their customers' financing and investment needs, significantly increasing their profitability and permitting them to compete more successfully with commercial banks. Indirectly, it also contributed to the growth of available credit outside the traditional banking system.[29]

This captures the essential elements of the threats that ILCs can pose to financial stability: conglomerates can use government-subsidized financing of an ILC to fund risky operations elsewhere in the corporate group, including risky capital market activities.

Some may question whether the practices and crisis fates of these financial firm owners of ILCs during the global financial crisis shed any light on the potential weaknesses of commercial firms that might apply to own an ILC. It is important to remember that neither General Electric nor General Motors began as financial firms. Instead, over time, these conglomerates used their ILCs to transform themselves radically, away from their industrial roots. During Jack Welch's tenure as CEO starting in 1981 General Electric gradually morphed into a "closet bank," becoming one of the seven largest financial institutions in the United States.[30] GE Capital was ultimately designated as a systemically important financial institution by the Financial Stability Oversight Council.[31] The ILC form represented an important piece of GE's financialization.[32]

It also proves difficult to articulate a clear dividing line between financial and nonfinancial owners of ILCs; the General Accounting Office noted the difficulty in making even this analytic distinction between types of owners.[33] A legally workable distinction between financial and nonfinancial owners would prove much more difficult.

B. Concerns with ILCs and the Expansion of ILCs

---

27 *Id*. at 6.

28 *Id*.

29 Omarova & Tahyar, *supra* note 16, at 164-165.

30 *GE Breaks Up; Electric Shock; An Iconic Firm Abandons Its Finance Business*, ECONOMIST (Apr. 10, 2015); Peter Eavis, *In G.E. Sale, End to Age of Hubris*, NY TIMES at B3 (Apr. 11, 2015).

31 Financial Stability Oversight Council, Basis of the Financial Stability Oversight Council's Final Determination Regarding General Electric Capital Corporation, Inc. (July 8, 2013) *available at* https://home.treasury.gov/system/files/261/General%20Electric%20Capital%20Corporation%2C%20Inc.pdf (last visited Apr. 10, 2021).

32 *See generally GE and Industrial Loan Companies: Parting Company*, ECONOMIST (June 27, 2009)

33 *GAO 2012 Report*, *supra* note 17, at 19.

The transformation of ILCs into complex financial institutions and the growth in the size and number of ILCs raises multiple concerns about the nature of the ILC exemption. The expansion of ILCs:

¶ Poses threats to financial stability;

¶ Creates an uneven playing field for other businesses;

¶ Generates potential conflicts of interest in lending; and

¶ Creates the potential for consumer abuses.

Most basically, ILCs are subject to inadequate supervision.

I begin with the last concern because it is essential to understanding the scope of all other concerns and threats. If regulators cannot adequately supervise a financial institution, they cannot adequately understand the extent to which it faces financial risks, poses threats to financial stability, would distort competition in commercial or banking markets, or affects consumer welfare. Without adequate supervision, regulators and policymakers are flying at least partially blind.

The Importance of Consolidated Supervision: ILCs are subject to FDIC supervision but not *consolidated* supervision by the Federal Reserve as are bank holding companies. The difference between supervision of an entity and consolidated supervision is critical. The FDIC scrutinizes an ILC and, to a lesser extent, certain affiliates within the ILC's corporate group with which it contracts. By contrast, consolidated supervision by the Federal Reserve encompasses the entire financial conglomerate. The Federal Reserve explained the risks of a lack of consolidated supervision of ILCs thus:

> … the ILC exemption creates special supervisory risks because an ILC's parent company and nonbank affiliates are not subject to consolidated supervision. Lack of consolidated supervision is problematic because the organization may operate and manage its businesses on an integrated basis, and, in the Federal Reserve's experience, risks that cross legal entities and that are managed on a consolidated basis cannot be monitored properly through supervision directed at any one, or even several, of the legal entity subdivisions within the overall organization. Moreover, history demonstrates that financial distress in one part of a business organization can spread, sometimes rapidly, to other parts of the organization.[34]

Managers of conglomerates can engage in complex intragroup transactions and even play games in ways that disadvantage an ILC subsidiary or allow the conglomerate to exploit the ILC's FDIC

[34] BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, FEDERAL DEPOSIT INSURANCE CORPORATION, & OFFICE OF THE COMPTROLLER OF THE CURRENCY, REPORT TO THE CONGRESS AND THE FINANCIAL STABILITY OVERSIGHT COUNCIL PURSUANT TO SECTION 620 OF THE DODD-FRANK ACT at 33-34 (Sept. 2016) *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160908a1.pdf (last visited Apr. 10, 2021).

deposit insurance. This is what securities firms did in the run-up to the global financial crisis. I explain this "subsidy transfer" and "leakage" problem further below.

For now, metaphors might help explain the limitations of supervision of an ILC compared to consolidated supervision. If supervision examines the health of an elephant and looks at how it touches other elephants in its immediate vicinity, consolidated supervision can see the risks to the elephants from the movement of its entire herd.[35]

Supervision of commercial entities: Even with its more limited supervisory scope, the FDIC faces daunting obstacles in supervising ILCs. No bank regulator has deep expertise or capacity to understand commercial entities. Even understanding complex *financial* operations and products beyond traditional depository banking presents serious challenges for regulators. Furthermore, ILCs, their parents, and their affiliates span a wide range of business models and industries. Student loan companies (like Nelnet) differ from payment companies (like Square), which in turn are very different animals than online retailers (Rakuten) and brick-and-mortar retailers (Walmart). Even consolidated supervision would struggle with *commercial* conglomerates.

Supervision of vast commercial enterprises raises the risk not only of weak regulators, but also of regulators that are too powerful. Giving any regulator authority over the financial and business decisions of a large swath of American enterprise should concern policymakers.

Risks to the FDIC fund; financial stability risks: Proponents of ILCs argue that large commercial parents could serve as "sources of strength" for ILCs, and that commercial operations could provide valuable diversification to protect nonbank banks.[36] The record of the stability of ILCs depends on the time horizon being considered.[37] As noted above, parents and affiliates of several prominent ILCs did not serve as sources of strength during the financial crisis of 2007 and 2008. Instead, these conglomerates required billions of dollars of extraordinary government assistance, including by the FDIC.

There have been other periods of instability for ILCs. Between 1985 and 2003, 21 ILCs failed. Many of these failures took place in Californian in the late 1980s and 1990s. Two ILC failures, in 1999 and 2003, imposed "material losses" on the FDIC fund.[38] It is not only the failure of an ILC that creates financial stability risks. By engaging in subprime lending and participating in

---

[35] Alternatively, one could compare FDIC supervision to studying only the strands of a spider web connecting to an ILC, while consolidated supervision by the Federal Reserve would examine the entire web with all its interconnections.
[36] *GAO 2012 Report*, *supra* note 17, at 23.
[37] Arguments in favor of lowering walls that segment financial services – for example rules separating banking from commerce or separating banking, securities, and insurance business – often cite the enhanced stability to a firm that comes from diversified business lines and investments across very different markets. With diversification, however, also comes the possibility of creating transmission lines for financial contagion to spread from one affiliate in a conglomerate to another or among different financial markets. *See generally* Erik F. Gerding, *How Law Improved the Transmission Lines between Real Estate and Banking Crises*, 50 GA. L. REV. 89 (2015).
[38] Government Accountability Office, Industrial Loan Corporations: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority at 59-60 (Sept. 2005) *available at* https://www.gao.gov/assets/gao-05-621.pdf (last visited Apr.14, 2021) [hereinafter GAO 2005 Report].

complex and opaque financial markets (including but not limited to securitization), ILCs have contributed to the buildup of systemic risk in financial markets.[39] The historical clustering of ILC and parent failures raises the possibility that the financial stability risk posed by ILCs may follow cycles or increase suddenly due to herd behavior.

Moreover, individual ILCs and their owners and the makeup of the overall ILC industry can change dramatically over time. FDIC approvals of ILCs based on applicants as they conduct business today may not fully capture risks as ILCs individually or collectively evolve. But how are regulators to adequately understand this evolution and adjust deposit insurance premiums or prudential regulation accordingly in the absence of consolidated supervision?

Distorted competition: As I explain below, the retailers, tech firms, and other commercial conglomerates most likely to succeed in obtaining an ILC charter and FDIC insurance are larger, established enterprises. FDIC insurance and other powers and privileges of banking would give conglomerates owning an ILC a competitive advantage over firms without an ILC. In short, the growth of ILCs threatens to distort competition in commercial markets far beyond the banking sector. The FDIC could take steps to price deposit insurance to counteract, at least in part, any subsidy. As I note below, however, risk-based pricing of deposit insurance has had mixed success.

Moreover, understanding the extent to which an ILC is conferring upon its conglomerate a subsidy and whether and how the conglomerate may be transferring and exploiting that subsidy requires consolidated supervision of the entire conglomerate.

Conflicts of interest: Scholars have also expressed concern that ILCs create conflicts of interest. For example, conglomerates could cause ILCs to extend risky loans to consumers or underprice them to the detriment of the ILC. ILCs also face strong incentives to make loans that favor purchases of their products and services, not competitors.[40]

Consumer Protection: These incentives to push the products and services of the conglomerate may also adversely affect consumer welfare. It is not clear that the FDIC has given enough consideration to how conglomerates might use their ILCs to engage in predatory consumer lending or to support predatory sales. Professor Adam Levitin cautions about the risks of commercial firms using bank operations to exploit consumers:

> The rise of a major consumer finance industry means that there are new reasons to be concerned about the separation of banking and commerce. Even if the corporate lending market is sufficiently regulated and competitive to ensure that bank-commerce affiliations do not distort the market, it is not clear that sufficient regulation exists in the consumer finance market. Retailers with major credit card operations present new regulatory challenges. To what extent should retailers be allowed to price their sales in order to drive their credit operations' profits? There is a long tradition of retailers offering purchase-money financing for their own wares. But this is not the same as retailers selling wares at reduced prices in order to exploit consumers' cognitive biases and uncapped interest rates. It is hard to know

---

[39] Wilmarth, *The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks*, *supra* note 13, at 4-8.
[40] *Id.* at 8-9.

> when the tail starts wagging the dog, but at some point a danger of predatory (and anticompetitive) sales emerges.[41]

Consumer protection risks may mushroom when layered on top of the capacities that many technology firms have in gathering data on consumers and altering the daily mix of information that consumers receive.

Distorted competition in banking: Granting ILCs the power and privileges of banking without all the supervision and capital and full prudential regulations that apply to banks may also distort *banking* markets. As explained below, this concern goes beyond ILCs having an unfair competitive advantage over banks; undermining the bank franchise would encourage greater bank risk-taking. It would also spur banks to push for banking deregulation, including of the rules that restrict them from owning commercial enterprises and engaging in nonbanking business. Moreover, the financial institutions most likely to suffer from distorted competition are the smallest community banks and credit unions.

Commitments to access: If one side of the ledger in granting ILCs points to risks, it is also important to scrutinize the purported benefits of ILCs. As noted above, ILCs were originally invented to serve the unmet banking needs of industrial workers. Modern ILCs may have a much different range of customers than their ancestors. If new ILCs are permitted and justified based on increasing access to the unbanked and underbanked, Congress should insist that ILC commitments to the FDIC, as well as FDIC regulations and supervision, ensure that these ILCs are actually focused on serving communities most in need, particularly communities that still suffer from the ravages of redlining and racial discrimination and other urban and rural communities without adequate banking.

III. The OCC FinTech Charter

In contrast to a century of ILCs and their precursors, the OCC's fintech charter has an incredibly short history. It also has very little supporting legal basis or policy analysis. In July 2018, the OCC released a "Policy Statement" of just over three pages announcing that a new policy that the OCC would issue charters to fintech companies even if they did not take deposits. This was accompanied by a 20 page (including cover page and table of contents) supplement to the Comptroller's Licensing Manual entitled "Considering Charter Applications From Financial Technology Companies." The Comptroller evidently did not feel it was necessary to engage in notice-and-comment rulemaking let alone to seek statutory authority from Congress to take the radical step of issuing a brand new type of charter to firms that do not take deposits.

A. The OCC contravened federal banking statutes and exceeded its authority.

The OCC's fintech charter contravenes the purpose and plain textual meaning of the National Bank Act, the 150-plus year old federal statute that created national banks and gives the OCC the authority to issue charters for them. The National Bank Act permits the OCC to charter

---

[41] Adam Levitin, *Payment Wars: The Merchant-Bank Struggle for Control of Consumer Payment Systems*, 12 STAN. J. L. BUS. & FIN. 425, 458 (2007).

only institutions that take deposits, with limited exceptions expressly created by Congress.[42] The OCC fintech charter also runs counter to the text, structure, and purpose of other core federal banking statutes, including the Federal Deposit Insurance Act, the Bank Holding Company Act, the Banking Act of 1933, and the Federal Reserve Act. All of these statutes rest on the fundamental assumption that national banks must be depository institutions.[43]

B. The harm in conferring bank powers and privileges via the fintech charter.

The harm from the OCC fintech charter goes beyond an agency exceeding its authority from Congress (which is offense enough). The OCC fintech charter would confer upon non-depository institutions certain powers and privileges of banks, without regulations governing this new category of institution or conditioning its powers. This contrasts with the hundreds of OCC provisions in the Code of Federal Register, decades of OCC Bulletins and Circulars, numerous OCC Interpretations and Actions, and two dozen licensing manual booklets that govern deposit-taking firms chartered by the OCC under explicit statutory authority from Congress.

Congress created national bank charters only for depository institutions because it was delegating to these firms the sovereign power of creating money and thus affecting the nation's money supply.[44] National banks increase the money supply by creating deposits. In exchange for receiving this sovereign power, national banks become subject to a host of prudential and consumer regulations. They also receive certain powers and privileges to enable them to perform their money creating function while not destabilizing the economy via bank runs or bank failures. These powers and privileges include the following:

¶ access to emergency loans from the Federal Reserve via the discount window (with the Federal Reserve acting as liquidity-provider-of-last resort);[45]

[42] In 1978, Congress amended the National Bank Act to authorize the OCC to charter non-depositor trust companies. Pub. L. 95-630, Title XV § 1504, 92 Stat. 3713 (Nov. 10, 1978) (codified at 12 U.S.C. § 27(a)). Congress made this change in response to a federal court case that ruled that the OCC did not have the authority under the pre-1979 National Bank Act to charter non-depository trust companies. Nat'l State Bank of Elizabeth v. Smith, No. 76-1479, 1977 U.S. Dist. LEXIS 18184 (D.N.J. Sep. 16, 1977) (unpublished opinion) *rev'd*, Nat'l State Bank of Elizabeth v. Smith, 591 F.2d 223 (3d Cir. 1979) (citing retroactive effect of 1978 amendments to National Bank Act).

[43] For a detailed analysis of how the OCC fintech charter contravenes the National Bank Act and these other statutes, see *Brief of Thirty-three Banking Law Scholars*, *supra* note 6.

[44] *See generally* Robert C. Hockett & Saule Omarova, *The Finance Franchise*, 102 CORNELL L. REV. 1143 (2017); MORGAN RICKS, THE MONEY PROBLEM: RETHINKING FINANCIAL REGULATION (2015); CHRISTINE DESAN, MAKING MONEY: COIN, CURRENCY, AND THE COMING OF CAPITALISM (2014); Lev Menand, *Why Supervise Banks? The Foundations of the American Monetary Settlement*, __ VAND. L. REV. __ (forthcoming 2021).

[45] *See* 12 U.S.C. § 347b(a); BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL RESERVE SYSTEM PURPOSES & FUNCTIONS at 41-44 (10th ed. 2016).

- ¶ master accounts with the Federal Reserve[46] (via which the Federal Reserve has traditionally enacted monetary policy);[47]
- ¶ access to the Federal Reserve's payment system;[48]
- ¶ access to the Federal Reserve's securities custody services;[49] and
- ¶ voting rights in electing the directors of the 12 district banks of the Federal Reserve.[50]

OCC fintech charters open the door for non-depository firms to receive many of these same powers and privileges without these firms:

- ¶ serving the vital function of creating deposits and thus money; or
- ¶ being subject to the full panoply of prudential and consumer regulations that govern national banks and other regulated depository institutions.

This is no small matter. For example, access to emergency loans and to the Federal Reserve's payments system would confer on these non-depository firms major competitive advantages over their commercial rivals. As explained below, granting certain commercial firms the power and privileges of banks would distort nonbanking markets and entrench the favored recipients.

C. This is about preemption of state laws.

Even being charitable, contravening the core federal banking statutes and over a century of practice limiting OCC charters to only depository institutions with a four page "Policy Statement" seems to be a stunt. However, it would be a stunt with significant consequences.

Creating a charter for a new class of firm without any clear limitations on what those firms can do seems to be a naked attempt simply to offer those firms preemption of a host of state laws. The OCC fintech charter would preempt state regulations on supervision, prudential regulation, and consumer protection that would otherwise govern the firms being chartered.

Preemption of state financial laws should be done by Congress not by the OCC in a four page "Policy Statement." Federalism is serious business even if some businesses seriously do not like federalism. Furthermore, the OCC's (and other federal bank regulators') preemption of state laws has had disastrous consequences in the past; the preemption of state laws that protected

---

46 *See generally* Board of Governors of the Federal Reserve System, Reserve Maintenance Manual "Account Structure" (Nov. 19, 2018) *available at* https://www.federalreserve.gov/monetarypolicy/reserve-maintenance-manual-account-structure.htm (last visited Apr. 12, 2021); Board of Governors of the Federal Reserve System, Federal Reserve Account Structure, Transaction Settlement and Reporting Guide (Nov. 2017) *available at* https://app.frbservices.org/assets/resources/rules-regulations/operating-circular-1-accnt-structure.pdf (last visited Apr. 12, 2021) (describing master accounts);
47 BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, THE FEDERAL RESERVE SYSTEM PURPOSES & FUNCTIONS at 38-40 (10th ed. 2016).
48 *Id*. at 42-46, 131-133.
49 *Id*. at 132.
50 12 U.S.C. § 304.

consumers from financial predation contributed to the severity of the 2007-2008 financial crisis.[51] As explained below, there are other, less destructive ways to help payments firms and other fintech companies who face a patchwork of state money transmission and other financial regulations.

D. The OCC fintech charter would open up exemptions for firms from important securities and other federal laws.

The OCC's fintech charter also opens potential exemptions for commercial firms from a host of important federal securities laws that protect investors. For example, the Securities Act of 1933 contains exemptions from registration requirements for securities issued or guaranteed by national banks.[52] This, in turn, removes important civil antifraud liability provisions.[53] Congress crafted these exemptions because deposit-taking national banks are subject to an entire architecture of federal prudential regulations that protects the safety and soundness of those firms.[54] Again, the OCC has not subjected to firms that would enjoy a fintech charter to any of these prudential regulations.

Exemptions from registration would leave investors and the broader public with inadequate public information about those firms receiving OCC fintech charters. Exemptions from federal securities laws would not only give these newly chartered firms advantages over other commercial firms, it would also chip away at essential investor protections and the disclosure that gives the public and policymakers confidence in securities markets.

The damage to federal securities laws might not end there. If the OCC fintech charter is allowed to stand, there are few constraints on the OCC's ability to grant charters to financial intermediaries that would otherwise be subject to federal investment company laws, such as the Investment Company Act of 1940.[55] In short, the OCC's fintech power grab threatens to intrude not only upon state laws but also on federal laws that protect investors and promote financial stability.

The OCC fintech charter creates further uncertainty in still other areas of federal law. "Banks" are exempted from the Bankruptcy Code, but the Code does not define the term "bank." The OCC fintech charter sows confusion as to whether firms receiving a fintech charter are subject to federal bankruptcy laws. This uncertainty works to the detriment of creditors.

Rather than attempt to plug the holes created by the OCC's fintech charter in federal laws and fix the problems creates by state preemption, Congress should end the OCC's adventure into novel charters of non-depository firms.

E. The fintech charter opens up the ability of the OCC to charter a vast range of commercial enterprises and federalize corporate law

---

51 Arthur E. Wilmarth, Jr., *The Dodd-Frank Act's Expansion of State Authority to Protect Consumers of Financial Services*, 36 J. CORP. L. 893,897-919 (2011).
52 15 U.S.C. § 77c(a)(2).
53 Sections 11 and 12(a)(2) of the Securities Act create liability only for registered or public offerings.
54 IFLR, Frequently Asked Questions about Section 3(a)(2) Bank Note Programs at 1, *available at* https://www.iflr.com/pdfsiflr/faqs-section-3a2-bank-note-programs.pdf (last visited Apr. 13, 2021)
55 *See Brief of Thirty-three Banking Law Scholars*, *supra* note 6, at 29-30.

If allowed to stand, the OCC's position on the fintech charter would impose few limits on it to charter other commercial enterprises. This would potentially unleash OCC power over vast swaths of American commerce. It would also federalize much of corporate law, which has historically been the domain of state law.[56] There are certainly arguments for federalizing corporate law, but that decision rests with Congress.

IV. Why Separate Banking from Commerce?; The Costs of Blurring the Boundaries

Telescoping outwards from the problems with the specific agency actions discussed above – the FDIC endowing new ILCs with deposit insurance and the OCC fintech charter – it may prove useful to outline the overarching policy concerns behind separating banking from commerce. Historically, policymakers, financial firms, lawyers, and scholars have focused much more on the question of why banks should be restricted from owning or conducting nonbanking commercial businesses. The partial repeal of the Glass-Steagall Act and bank regulators giving banks greater flexibility in conducting nonfinancial activities –both of which were to my mind unwise – have also opened another Pandora's Box, allowing more commercial firms into banking.

Many of the same concerns that animate keeping banks out of commerce also justify keeping commercial firms out of banking. Most broadly, commercial firms should be kept out banking because of the fears of three types of concentrations: concentrations of credit, concentrations of economic power, and concentrations of political power. More specifically, giving commercial firms the powers and privileges of banking raises concerns of:

¶ *Distorting competition in commercial markets;*

¶ *Threatening financial stability;*

¶ *Distorting competition in banking markets and encouraging excessive risk-taking;*

¶ *Creating conflicts of interest;* and

¶ *Exploiting consumers.*

I discuss each of these concerns below.

A. Concentrations of credit

Fears of a handful of banks dominating credit markets animates restrictions on banks owning commercial enterprises. This same concern increasingly applies to commercial firms entering banking. The entry of commercial firms might *increase* competition with banks. However, commercial firms enjoy advantages that could drive smaller community banks and credit unions out of business. The advantages of big retail and technology conglomerates include:

56 *Id.* at 23-27.

Large retailers could easily create vast branch networks: Walmart's latest annual report notes that each week it serves "over 240 million customers who visit approximately 11,400 stores" in addition to its growing online sales.[57]

Tech firms could push out banking services via smartphone apps or otherwise bundle them with existing online services. Imagine the ease with which Amazon could market banking services to consumers on its platform.

Tech firms have advantages in new technologies including artificial intelligence and machine learning, consumer interfaces, data management, cloud computing, and mobile payments.[58]

These advantages are not necessarily bad considered in isolation. Indeed, many would redound to the benefit of consumers by offering greater speed and convenience.

The risk, however, is that the same high levels of concentration that afflict certain retailing and tech markets would cross over into financial services markets. A handful of tech firms could dominate credit markets. In a not-implausible nightmare scenario, banking could devolve into an arena in which the principal players are Big Wall Street, Big Retail, and Big Tech or some alliance among the three.

B. Concentrations of economic power

Conferring upon commercial firms the powers and privileges of banking could also lead to concentrations of economic power in commercial markets outside of banking and financial services. As noted several times in this testimony, larger commercial firms with more economic, legal, and political resources are more likely to obtain nonbank bank charters than smaller retailers and startup tech firms. These conglomerates could then leverage banking powers and privileges to undercut rivals and entrench market dominant positions.

As discussed below, regulators would have difficulties detecting and counteracting the explicit and implicit government subsidies that may come with these powers and privileges. Regulators face difficulties in ensuring that commercial conglomerates do not transfer and exploit these subsidies among their various affiliates. These difficulties compound when bank regulators must supervise far flung commercial enterprises. *They become possibly insurmountable in the absence of consolidated supervision* – the ability of regulators to monitor the conglomerate as a whole.

This raises the specter of Big Tech, Big Retail, and Big Wall Street exercising dominance not only in financial services but also across many different sectors of American commerce. These fears become particularly salient in the retailing, tech, and payments industries.

---

57 Walmart Inc. Form 10-K for the Fiscal Year Ended January 31, 2021 at 6 *available at* https://www.sec.gov/ix?doc=/Archives/edgar/data/104169/000010416921000033/wmt-20210131.htm (last visited Apr. 13, 2021).

58 Wilmarth, *The OCC's and FDIC's Attempts to Confer Banking Privileges on Nonbanks and Commercial Firms Violate Federal Laws and Are Contrary to Public Policy*, 39 Banking & Fin. Svcs. Pol'y Rep. No. 10, at 10 (Oct. 2020) *available at* https://scholarship.law.gwu.edu/cgi/viewcontent.cgi?article=2780&context=faculty_publications (last visited Apr. 11, 2021).

Entrenching already entrenched giant retailers and tech firms: Conferring banking powers and privileges on non-banks will compound existing antitrust concerns surrounding the largest retailers and tech firms. Small and mid-sized retailers face particular vulnerabilities at this historical moment; we do not know the long run impacts on smaller firms due to the pandemic. In short, granting bank powers and privileges on nonbanks would be "disruptive," but there is a substantial risk it would favor already large commercial firms and permanently tilt the landscape of American commerce further in their favor.

Putting the thumb on the scales of payment networks: Even without affording banking powers and privileges to non-banks, competition concerns are endemic to the world of payment networks. This owes to the fact that payment networks exhibit "network effects." In other words, a particular payment platform becomes increasingly economically valuable when more consumers and merchants use it.[11] Bank regulators should not compound competition concerns and put their thumbs on the market scales by affording select non-bank payment providers with the powers and privileges of banks.

Antitrust deference must be removed: Moreover, various doctrines and regulatory practices in antitrust law work to blunt antitrust review in banking and other regulated financial services sectors.[59] When seen charitably, these doctrines and practices stem from beliefs that antitrust law should not frustrate carefully designed legal regimes that meet other public policy goals, such as promoting financial stability. Yet the recent OCC and FDIC actions do not appear carefully designed and risk undermining fundamental public policies that animate banking law, including safeguarding financial stability and protecting consumers. *Accordingly, if the FDIC is permitted to continue to approve ILCs or the OCC is allowed to issue fintech charters, Congress should explicitly remove any presumptions or obstacles that make courts, antitrust regulators, or financial regulators deferential when reviewing competition concerns involving non-bank firms with bank charters.*

C. Concentrations of political power

Since the earliest days of the republic, one of the most fundamental concerns of banking law has been the capacity of concentrated banking power to lead to concentrations of political power.[60] This concern remains even as the debates have shifted over the decades. Highly concentrated and politically influential commercial industries could amass even greater political power when afforded the privileges that come with bank charters – regardless of the name of those charters. Concerns with agglomerations of political power become even more pressing when technology firms wield enormous influence over the day-to-day, moment-to-moment information individuals receive about politics, as well as about products and services and daily life. Adding bank powers to the capacities of these firms only compounds democratic concerns.

[11] *See generally* RONALD J. MANN, PAYMENT SYSTEMS AND OTHER FINANCIAL TRANSACTIONS 299 (5th ed. 2011); Mark Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CAL. L. REV. 479 (1998). *See generally* James Surowiecki, *Bitcoin would be a Calamity, not an Economy*, 121(3) MIT TECH. REV. 28, 28-9 (May/June 2018).

[59] For a history of weaknesses in antitrust scrutiny of banking and bank mergers, see Jeremy C. Kress, *Modernizing Bank Merger Review*, 37 YALE J. ON REG. 435 (2020).

[60] For a classic account of the early history of politics and banking, see BRAY HAMMOND, BANKS AND POLITICS IN AMERICA FROM THE REVOLUTION TO THE CIVIL WAR (1957).

Political power can be concentrated in another dimension. Giving bank regulators potentially vast oversight authority over commercial enterprises should scare policymakers concerned with overreach by financial regulators, not to mention any citizen interested in limits on government authority. The separation of commerce and banking constrain not only the power of banks and the power of commercial conglomerates, but also the powers of government officials.

D. Distorting competition with commercial firms

Conferring banking powers and privileges on non-banks threatens to distort not just banking but also commercial markets by creating an uneven playing field. Non-banks who could access the special privileges of banking – including deposit insurance, access to the Federal Reserve discount window, and exemptions from a host of federal and state laws – could use these privileges to undercut rivals. These non-banks would wield unique legal powers and may enjoy a lower cost of capital thanks to government loans and guarantees both explicit (*i.e.*, deposit insurance) and implicit (*e.g.,* too-big-to-fail status).

Subsidy transfers and subsidy leakage: Part, but not all, of the competitive advantage that non-banks would enjoy by virtue of licenses that grant them power and privileges of banks stems from subsidies that come from deposit insurance and access to emergency government loans. Deposit insurance and access to liquidity from the government as lender-of-last-resort represent essential pillars of banking; they mitigate the risk of bank runs, which can trigger broader panics and financial crises. Bank regulators and central banks have long recognized that these subsidies need to be countered to mitigate moral hazard. However, these subsidies *also* need to be countered in order to prevent distortions in the marketplace. This second concern – preventing competitive distortion -- becomes paramount when walls separating banking and commerce crumble and banks start commercial activities or commercial firms begin banking.

The problem is that regulators and central banks face massive challenges in negating these subsidies and have a checkered record in their attempts. For example, Congress has required that the FDIC price its deposit insurance according to the riskiness of individual banks.[61] However, the FDIC has struggled to price deposit insurance premia for systemic risk.[62] As detailed above, the FDIC, other bank regulators, and the Treasury Department provided billions of dollars in emergency support to the parents of multiple FDIC-insured ILCs. During the crisis, the losses to the FDIC's fund became so severe that the agency needed to take emergency steps to restore fund levels.[63]

---

61 FDIC Improvement Act of 1991, Section 302(a), Pub. L. No. 102-242, 105 Stat. 2236. For a history of risk-based pricing for deposit insurance premia, see Federal Deposit Insurance Corporation, Staff Studies Report No. 2020-01
A History of Risk-Based Premiums at the FDIC (Jan. 2020) *available at* https://www.fdic.gov/analysis/cfr/staff-studies/2020-01.pdf (last visited Apr. 7, 2021).

62 For one analysis of the challenges of pricing deposit insurance, see Viral V. Acharya et al., *Systemic Risk and Deposit Insurance Premiums*, Fed. Res. Bank N.Y. Econ. Pol'y Rev. at 89 (Aug. 2010) *available at* https://www.newyorkfed.org/medialibrary/media/research/epr/10v16n1/1008yoru.p (last visited Apr. 7, 2021).

63 FEDERAL DEPOSIT INSURANCE CORPORATION, CRISIS AND RESPONSE: AN FDIC HISTORY, 2008–2013 at 155-161 (2017)

Federal bank regulators has also struggled and often failed with efforts to contain subsidies to bank affiliates operating within large financial conglomerates. The Federal Reserve has struggled to create and police effective "firewalls" or other institutional mechanisms to prevent subsidy transfers within bank holding companies.[64] It is thus difficult to imagine the FDIC or OCC succeeding in preventing complex *commercial* conglomerates from transferring and exploiting subsidies from chartered affiliates to other companies under their corporate umbrella. Large commercial firms could then use these subsidies to undercut rivals. As noted above, ILCs operate outside Federal Reserve *consolidated* supervision, and even bank regulators with supervisory powers face daunting challenges in overseeing the operations of complex commercial firms, particularly technology firms. Subsidies to bank affiliates within conglomerates inevitably leak.

Moreover, many government subsidies in banking and financial services are *implicit* or created by market expectations despite government disavowals. Too-big-to-fail status represents just one example. There is a long academic literature on how market expectations can create implicit deposit insurance and how difficult it is for governments to counter these expectations.[65] Implicit subsidies would provide commercial firms with additional advantages over competitors.

Market distortions, at their worst, can contribute to entrenched monopolies or oligopolies.

E. Financial Stability

Conferring banking power and privileges on commercial conglomerates also creates risks to financial stability. As noted above, there are arguments that commercial firms would serve as "sources of strength" for financial affiliates and provide diversification. However, the failures of, and massive government assistance given to, parents of ILCs during the global financial crisis of 2007-2008 provides a cautionary tale. Moreover, the business models of commercial firms do not remain fixed at the time they might receive banking powers and privileges. General Electric became increasingly a bank and less of an industrial company. In the absence of consolidated supervision, bank regulators would have little early warning of systemic risk building up inside a commercial conglomerate with banking powers and privileges.

F. Distorting Banking Markets

Granting non-banks the powers and privileges of banking without subjecting them to the same supervision and regulation of banks threatens to distort and destabilize banking markets. These distortion would have repercussions for financial stability and for the communities that banks serve.

ILCs provide a telling example: they have access to FDIC deposit insurance like banks yet fall outside consolidated supervision by the Federal Reserve. As noted above, effective consolidated supervision and prudential regulation provide essential mechanisms to mitigate the moral hazard that comes with deposit insurance, access to central bank loans and liquidity, and other privileges of banking. Moreover, effective supervision and prudential regulation is necessary to counteract any

---

64 *See, e.g.*, Saule T. Omarova, *From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N.C. L. REV. 1683 (2011).

65 *E.g.*, DAVID HOELSCHER ET AL., THE DESIGN AND IMPLEMENTATION OF DEPOSIT INSURANCE SYSTEMS AT 2 (Dec. 2006).

subsidy, explicit or implicit, that comes with these privileges. Granting nonbanks banking privileges without effective supervision and regulation creates a competitive advantage for nonbanks.

Risk-taking by banks: These distortions created by regulation do not merely offend market principles. They also threaten to destabilize banking markets by creating incentives for banks to take additional and excessive risks to compete with privileged but less-regulated nonbanks. This is not mere speculation, but rather a core axiom from banking economics. Gary Gorton explains:

> "The history of banking in the United States implicitly revolves around a conflict between charter value, which creates an incentive for banks not to become too risky, and competition, which creates risks. If a bank is deemed insolvent, it loses its charter . . . so the higher a bank's charter value, the higher the incentive it has to avoid risk. But as companies without bank charters compete with banks by offering the same services, the value to a bank of having a charter decreases, and to compete and stay afloat, a bank must take on more risk."[66]

Competition between lightly regulated non-banks with banking privileges and banks has contributed to destructive spirals of competition, which in turn have resulted in excessive risk-taking and cheap credit and ignited financial crises.[67]

Favoring the biggest banks and tech firms: Competition from nonbanks with banking powers and privileges may prove particularly devastating for smaller community banks and credit unions, who already face daunting competition from the largest banking conglomerates. It is not the mission of government to shelter smaller banks from all the gales of competition and technological change. However, Congress should consider the effects on underserved communities nationwide that rely on community banks and credit unions.

A healthy and diverse banking ecosystem – that provides broad access to deposits, credit to households and small business, and payments services – would include entities with a range of sizes, organizational forms, clienteles, and missions.[68] One example of the benefits of a diverse ecosystem: research has shown that banks with certain organizational forms, such as cooperatives and mutuals, take less investment risk and offer more consumer-friendly terms when compared to investor-owned banks organized as corporations.[69] Federal bank regulators should work towards fostering diversity among sizes, types, and community missions of banks. They should avoid steps that would

---

[66] GARY GORTON, MISUNDERSTANDING FINANCIAL CRISES: WHY WE DON'T SEE THEM COMING 126-7 (2012).

[67] *E.g.*, Erik F. Gerding, *Deregulation Pas de Deux: Dual Regulatory Classes of Financial Institutions and the Path to Financial Crisis in Sweden and the United States*, 15 NEXUS 135 (2010). For an analysis of the interplay of competition and prudential bank regulation, see Prasad Krishnamurthy, *George Stigler on His Head: The Consequences of Restrictions on Competition in (Bank) Regulation*, 35 YALE J. ON REG. (2018).

[68] *See generally* Marc Schneiberg, *Toward an Organizationally Diverse American Capitalism? Cooperative, Mutual, and Local, State-Owned Enterprise*, 34 SEATTLE U. L. REV. 1409 (2011); Marc Schneiberg, *Organizational Diversity and Regulatory Strategy in Financial Markets: Possibilities for Upgrading and Reform*, 18 N.C. BANKING. INST. J. 141 (2013).

[69] *E.g.*, Erik F. Gerding, *Remutualization*, 104 CORNELL L. REV. 797, 821 (2020); Ryan Bubb & Alex Kaufman, *Consumer Biases and Mutual Ownership*, 105 J. PUB. ECON. 39, 39-42, 46 (2013).

accelerate banking consolidation and dominance by a handful of banking, retail, and tech conglomerates.

Consolidated Supervision: The distortive impacts of nonbanks enjoying banking powers and privileges could be partially ameliorated by bank regulators subjecting nonbanks to appropriately intensive supervision. There are serious obstacles, however, to this occurring. Some obstacles arise because of legal regimes: ILCs enjoy FDIC deposit insurance without the consolidated supervision that the Federal Reserve exercises over bank holding companies. Other obstacles are practical: as specialized bank regulators, the OCC and FDIC face daunting challenges in overseeing the complex global business operations of retail and technology conglomerates.

Still other obstacles are structural: even aside from concerns with revolving doors, races-to-the-bottom, and interest group clientelism, regulators already face disincentives to regulate strenuously firms upon whom they depend for licensing fees.[70] Federal regulators already struggle mightily with supervising *financial* conglomerates,[71] and bank supervision as a regulatory tool now faces a sustained attack by banks and their lawyers.[72] All these problems began before adding additional responsibilities on bank regulators to supervise commercial firms.

V. Slippery Slopes and the Value of Traditional Institutional Categories

One of the lessons of the evolution of ILCs is that technological and market developments can radically transform statutory categories of banks far beyond what Congress may have intended. The number, size, and types of firms taking advantage of nonbank charters can evolve over time.

It is difficult for regulators to make legally defensible distinctions that would allow Rakuten but not Amazon or Square but not Google to gain nonbank charters. Moreover, lawyers use their craft, with the help of ambitious regulators looking to deregulate, to expand statutory and regulatory loopholes to enhance the powers of their clients and reduce regulatory constraints. Much of this can occur in the murky waters of informal agency actions, such as agency interpretations and policy statements.[73] The OCC fintech charter provides a prime example of this. Informal agency actions are not always ideal; they can frustrate Congressional and public oversight of agency decisions that favor particular industries at the public expense.

Deregulation of one category of firms inevitably leads to rivals in another legal category pushing for deregulation of their own sector. Faced with competition from nonbanks that enjoy

---

70 *E.g.*, Arthur E. Wilmarth, Jr., *The Financial Services Industry's Misguided Quest to Undermine the Consumer Financial Protection Bureau*, 31 REV. BANKING & FIN. L. 881, 912-13 (2012). *Cf.* Binyamin Appelbaum, *By Switching Their Charters, Banks Skirt Supervision*, WASH. POST, Jan 22, 2009 at A1.

71 Lev Menand, *Too Big to Supervise: The Rise of Financial Conglomerates and the Decline of Discretionary Oversight in Banking*, 103 CORNELL L. REV. 1527 (2019).

72 *See, e.g.*, Lev Menand, *Why Supervise Banks? The Foundations of the American Monetary Settlement*, __ VAND. L. REV. __ (forthcoming 2021) (describing how mixing banking and commerce undermined supervision and the "desupervision" movement).

73 Earlier work of Saule Omarova has explored how agencies and incrementally expand bank powers. Saule T. Omarova. *The Merchants of Wall Street: Banking, Commerce, and Commodities*, 98 MINN. L. REV. 265 (2013 (permitting expansion of banks into physical commodities and energy businesses); Saule T. Omarova. *The Quiet Metamorphosis: How Derivatives Changed The "Business of Banking"*, 63 U. MIAMI L. REV. 1041 (2009) (permitting bank expansion into derivatives business).

bank powers and privileges without bank-level supervision and regulation, banks and bank holding companies will inevitably push for deregulation. In particular, banks may push for greater permission to enter into commercial activities. This would accelerate already dangerous trends by which regulators have incrementally expanded bank's nonfinancial activities in ways that have flown under the public's radar. Federal bank regulators have used interpretations and other formal and informal administrative law mechanisms to expand the activities that qualify as the "business of banking" or are "incidental" to financial activities.[74]

This dynamic can devolve into spirals of regulatory arbitrage and deregulation in which competing categories of financial institutions alternately sidestep rules or push for their repeal.[75] Clear categories that define banks with few exceptions and exemptions and strictly delimit bank powers have multiple benefits, including:

- ¶ Allowing market participants and policy makers to more easily understand the financial system, identify problematic subsidies to financial institutions, and map systemic risk;
- ¶ Reducing regulatory arbitrage that undermines prudential and consumer regulations and distorts competition;
- ¶ Settling expectations of market participants; and
- ¶ Setting guardrails on the powers of regulators.

Clarity and simplicity have strong value in financial regulation

VI. **The Role of State Regulators**

The details of federalism in banking law can be messy and difficult to understand. The FDIC chartering of new ILCs and the OCC's creation of a fintech charter seem to cut in opposite directions with respect to state regulators. The FDIC action grants more power to those states, particularly Utah, that charter ILCs, while the OCC's fintech charter would operate to preempt many state consumer protection and other laws.

Articulating three first principles may help make sense of how Congress should act to ensure an appropriate role for states to regulate both banks and commercial firms offering bank-like services.

First, state regulators play the most productive roles in banking law when they address concerns, like consumer protection, that directly affect their residents. State law become less justifiable when they affect a financial institution's operations in other states – for example, when

---

[74] *See sources supra* note 73.
[75] ERIK F. GERDING, BUBBLES, FINANCIAL REGULATION, AND LAW ch. 6 (2014) (detailing spirals of regulatory arbitrage and deregulation; Erik F. Gerding, *Deregulation Pas de Deux: Dual Regulatory Classes of Financial Institutions and the Path to Financial Crisis in Sweden and the United States*, 15 NEXUS 135 (2010)

national banks can "export" usury laws of the state where they are chartered.[76] Legislators and regulators of Utah are not accountable to the citizens of Rhode Island.

Second, state law and state regulators work better when they set floors rather than ceilings with respect to consumer protection and financial stability. Allowing state laws to create ceilings can spark races-to-the-bottom, which can be particularly destructive in the case of prudential regulation. The fallout from the failure of a bank – by whatever name – does not respect state boundaries.

Third, even in cases where a particular kind of chartered firm has operations with impacts that cross state borders there may still be a valuable role for state regulators for frontline supervision, examination and enforcement with respect to smaller firms or local operations. Federal regulators face resource constraints that can hamper effective supervision, examination, and enforcement. The federal securities regulatory regime for investment advisers offers one model in that it assigns registration and examination authority with respect to smaller advisers to state regulators.[77]

VII. Immediate Recommendations for Congress

Unfortunately, regardless of who are the immediate next heads of the OCC and FDIC, Congress has no assurance that future agency heads will faithfully follow statutory limitations on chartering nonbanks or endowing them with the powers and privileges of banking. The former heads of the OCC and the current head of the FDIC believe (in the case of the OCC, mistakenly) that they have the statutory authority to confer fintech charters and ILC deposit insurance. If it wants to stop these Pandora charters, Congress has no choice but to legislate.

Moratoriums, such as those in the Dodd-Frank Act on granting deposit insurance to new ILCs, function mainly as stop gap measures. Moratoriums expire, which then permit future agency power gabs at the expense of Congress, states, financial stability, consumers, and the separation between banks and commerce. *I would therefore support the Close the ILC Loophole Act being considered by this Subcommittee first and then the "Bank Charter Review Act" only if the Subcommittee deems the other bill infeasible.*

Accordingly, I recommend that Congress take the following clear and decisive steps:

A. Congress should end the ILC exemption and subject existing ILCs to the Bank Holding Company Act.

The expansion of ILCs, their drift from their original mission, and the risks they pose described above all argue for the elimination of the ILC exemption to the definition of "bank" in the Bank Holding Company Act. The FDIC should not grant deposit insurance to new ILCs and

---

76 The Supreme Court's decision in *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.* (39 U.S. 299 (1978)) enabled national banks to charter in states with very permissive usury rules and then charge higher credit card interest rates to customers in other states.

77 U.S. Securities & Exchange Commission, General Information on the Regulation of Investment Advisers (Mar. 11, 2011) *available at* https://www.sec.gov/divisions/investment/iaregulation/memoia.htm (last visited Apr. 14, 2021).

existing ILCs should be subject to the Bank Holding Company Act and consolidated supervision by the Federal Reserve.

I therefore support the "Close the ILC Loophole Act" that Representative Garcia has introduced and which was referred to this Committee. The bill contains provisions to allow for an orderly end to this exemption. I have not seen evidence that the end of this exemption will disrupt credit markets or cause undue concentrations that would adversely impact borrowers. In 2012, the GAO found that:

¶ The relatively small market shares of ILCs and other categories of nonbanks exempt from the Bank Holding Company Act meant that removing the ILC and other exemptions from the Bank Holding Company Act would have only a limited potential impact on the overall credit market;[78] and

¶ Removing the Bank Holding Company Act exemptions, including the ILC exemption, "would likely not affect concentration in overall credit markets.[79]

In other words, credit would continue to flow from other financial institutions, who would not enjoy market dominant positions if exempt nonbanks completely exited the market.

This GAO study is now almost 9 years old (which does argue for an updated study, such as that required by the proposed Bank Charter Review Act). However, the fact that ILCs can grow rapidly underscores a crucial lesson for Congress: if new ILCs enter the marketplace and receive FDIC insurance or if the OCC fintech charter is allowed to proceed, significant growth among these nonbanks may make it increasingly difficult to address problems in these markets.

B. Congress should preclude the OCC Fintech charter and underscore that the OCC may only charter deposit-taking entities.

I believe it is clear that the OCC fintech charter runs counter to the National Bank Act and the text, purpose, and structure of other federal banking statutes. I also believe federal courts will ultimately invalidate this OCC action. Nevertheless, in order to preclude aggressive statutory interpretations and power grabs by future Comptrollers, Congress should make a crystal clear amendment to the National Bank Act removing the ability of the Comptroller to issue any new charters to entities that do not take deposits.

VIII. Longer-term Approaches to Market Needs

Payment companies that have or may seek ILC or fintech charters are often responding to legitimate market needs and not just seeking to engage in regulatory arbitrage. However, Congress can help payment companies meet challenges in the regulatory environment and fill the unmet financial services needs of communities in alternative ways without conjuring the host of policy concerns raised by conferring banking powers and privileges on commercial firms.

---

78 *GAO 2012 Report*, *supra* note 17, at 36-37.
79 *Id.* at 38-41.

A. The patchwork of state money transmitter statutes

Payments companies face the difficulty of complying with state money transmitter statutes in each state in which they conduct business. 49 states,[80] the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands have money transmission statutes or regulations requiring licenses for money transmission. I have examined dozens of state money transmitter statutes.[81] Some are extremely hard to understand. However, these statutes as a whole do play important roles in combatting money laundering, protecting consumers, and ensuring the solvency of payment providers.

Instead of allowing a blanket preemption of these state laws thanks to the OCC fintech charter, Congress would promote the use of uniform statutes like the Uniform Money Services Act (2000). The impetus for these statutes, after all, was the federal antimony laundering regime.[82] Even should Congress chose to federalize money transmission laws, it should consider the valuable role that state regulators can play in creating floors (not ceilings) for consumer protection and in examining smaller financial firms.

B. Unbanked/underbanked communities and public options

Many communities face problems accessing banking services, including basic payments services. No Americans should have to turn to predatory businesses for basic services like cashing a paycheck or sending small amounts of money to relatives. Transaction fees can eat away at funds working families need.

But conferring bank charters, powers, and privileges on nonbanks is far from the only solution to these unmet needs. Congress should consider whether public options can help underserved communities. Postal banking,[83] "fed accounts for all"[84] and a "people's ledger"[85] represent just some of the proposals in the marketplace for ideas. A full consideration of the relative advantages and drawbacks of different public options is beyond the scope of this testimony.

However, the urgency of the need became stark during the pandemic. The federal government lacked the infrastructure to deliver relief payments quickly and electronically to households and small businesses. Mailing physical stimulus checks and delivering support to small businesses via an elaborate bank-centered program created delays in economic relief reaching communities. European countries were able to make payments, including payroll support payments to small businesses, electronically.[86] Investments in public financial infrastructure are just as necessary as investments in physical infrastructure.

---

[80] Montana does not have a money transmission statute.
[81] GERDING, NEGOTIABLE INSTRUMENTS, *supra* note 2, at ch. 28.
[82] 18 U.S.C. § 1960. *See* GERDING, NEGOTIABLE INSTRUMENTS, *supra* note 2, at § 28.01.
[83] Mehrsa Baradaran, *It's Time for Postal Banking*, 27 HARV. L. REV. F. 165 (2014).
[84] Morgan Ricks et al., *FedAccounts: Digital Dollars*, 89 GEO. WASH. L. REV. 113 (2021).
[85] Saule T. Omarova, *The People's Ledger: How to Democratize Money and Finance the Economy*, _ VAND. L. REV. __ (forthcoming).
[86] *E.g.*, United Kingdom BDO, Coronavirus Job Retention Scheme: Everything You Need to Know *available at* https://www.bdo.co.uk/en-gb/insights/tax/employer-essentials/coronavirus-job-retention-scheme#How%20will%20CJRS%20payments%20be%20paid%20to%20us? (last visited Apr. 11, 2021).

C. Costs to merchants of payment networks

Interchange fees imposed by the two main credit/debit card networks impose significant costs on merchants. Merchants have had little ability to negotiate these fees given the market dominance of Visa and Mastercard. Forming an ILC could help a large retailer like Walmart recoup some of these interchange costs. However, again, owning an ILC is only a viable option for large retailers. Technological change or the emergence of rival payment networks may reduce impact of interchange fees on merchants.[87] Congress and regulators could also revisit the regulation of interchange fees which began with the Durbin Amendment to the Dodd-Frank Act.[88]

IX. Related Issues for the Subcommittee's Future Agenda

Finally, I would like to take this opportunity to lay out a few additional issues for future consideration by this Subcommittee that are adjacent to the topic of conferring bank powers and privileges on nonbanks.

First, customers with certain kinds of accounts with payment providers may not understand that monies in those accounts do not enjoy federal deposit insurance. As noted above, it may prove difficult to disabuse consumers of even misconceived expectations of deposit insurance.[89]

Second, nonbank conglomerates with "bank" affiliates, particularly technology firms, may have tremendous ability to exploit customer/consumer data. Combining their normal data collection practices with the power and privileges of banking may create new risks for data privacy and data exploitation. One of the bright spots of the Gramm-Leach Bliley Act was the enactment of early, albeit incomplete, privacy protection provisions.[90] These provisions apply, however, only to "financial institutions."[91] To the extent Congress permits bank regulators to confer the power and privileges of banking on nonbanks, entire nonbank conglomerates should be subject to strict data privacy rules.

---

[87] *See generally*, Adam J. Levitin, *Payment Wars*, 12 STAN. J. L. BUS. & FIN. 425 (2007).

[88] For a description of the Dodd-Frank provisions on interchange fees and competitive practices by payment networks, see GERDING, NEGOTIABLE INSTRUMENTS, *supra* note 2, at §§ 19.21, 20.04.

[89] Adam J. Levitin, *Pandora's Digital Box: The Promise and Perils of Digital Wallets*, 166 U. PA. L. REV. 305, 344-345 (2018).

[90] This resulted in the GLB Data Privacy Rule, which is codified at 16 C.F.R. pt. 313.

[91] 16 C.F.R. § 313.1. The rule defines "financial institution" as follows:

> "… any institution the business of which is engaging in financial activities as described in section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)). An institution that is significantly engaged in financial activities is a financial institution." 16 C.F.R. § 313.3(k)(1).

EMORY LAW

Written Testimony of

Kristin Johnson, Asa Griggs Candler Professor of Law, Emory University School of Law

Before the United States House of Representatives Committee on Financial Services
Subcommittee on Consumer Protection and Financial Institutions

Examining "Banking Innovation or Regulatory Evasion?:
Exploring Trends in Financial Institution Charters"

Thursday, April 15, 2021
10:00 am
2128 Rayburn House Office Building

Chair Perlmutter, Ranking Member Luetkemeyer, and Members of the Subcommittee:

Thank you for inviting me to this hearing. My name is Kristin Johnson. I am the Asa Griggs Candler professor of law at Emory University School of Law, where I teach courses on corporate and securities law, the integration of emerging technologies into financial markets, including distributed digital ledger technologies such as blockchain and the assets these technologies enable (e.g., cryptocurrencies) and the assemblage of technologies commonly described as artificial intelligence technologies. Prior to assuming my current role, I served as the McGlinchey Stafford Professor of Law and Gordon Gamm Fellow at Tulane University Law School ("Tulane"). While at Tulane, I was delighted to serve as the Associate Dean for Faculty Research, the Director of the Program on Financial Market Stability in the Center for Law and the Economy, and as an affiliate of the Murphy Institute, an independently endowed, interdisciplinary (law, political science and economics) undergraduate and graduate school department at Tulane University.

My research and publications examine and promote regulatory, legislative, and market participants' efforts to achieve the core values that intimate financial markets regulation: promoting consumer protection, maintaining fair and orderly markets, and ensuring the safety and soundness of financial market stability. I am here today solely in my academic capacity and am not testifying on behalf of any entity.

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

As your Committee has noted, over the last several years, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation have taken steps to allow firms to engage in banking activities while being subject to less regulations and supervision compared to most other banks and credit unions. My comments below paint a portrait in broad strokes of the colossal technology firms that chiefly provide commercial and consumer services as well as smaller technology based platforms operating on the fringes or in the shadows of payment, custody, and monetary transfer services that seek to penetrate financial services markets. Due to the evolving nature and endemic concerns inherent in the underlying technologies, it is imperative to recognize the limits and perils of permitting these entities to interface directly with consumers in a lightly regulated, and in some instances, unregulated market. These reflections coupled with our historic commitment to the separation of banking and commerce, should lead us to be cautious rather than cavalier in approaching decisions to issue charters or extend deposit insurance protection to such enterprises.

Fintech Firms

Over the last decade, a growing number of digital startups launched bids to lure business from the financial services industry.[1] Increasingly, large technology platforms engaged essentially in commercial activities and social media platforms seek opportunities to conduct bank-like business. Amazon, Google, Facebook, for example, have launched a growing array of consumer credit and financial transactions services. These firms comprise a small subset of a burgeoning spectrum of businesses integrating complex technologies and financial services. Armed with vast quantities of data and sophisticated algorithmic (supervised and unsupervised machine learning) platforms or inspired by the creation and potential of blockchain-based technologies,[2] these financial technology ("fintech") firms[3] have revived long-standing debates regarding the architectural design,[4] regulatory framework,[5] and role of the financial services industry.[6] "Fintech" is a catch-all term used to refer to the digital platform or internet-based financial services firms that engage

---

1. Andrew Ross Sorkin, *Fintech Firms Are Taking On the Big Banks, but Can They Win?*, N.Y. TIMES: DEALBOOK (Apr. 6, 2016), https://www.nytimes.com/2016/04/07/business/dealbook/fintech-firms-are-taking-on-the-big-banks-but-can-they-win.html [https://perma.cc/8Z6C-DWKQ]; *The Fintech Revolution*, ECONOMIST (May 9, 2015), https://www.economist.com/news/leaders/21650546-wave-startups-changing-financefor-better-fintech-revolution [https://perma.cc/UWF3-Z7PZ].

2. FTC, BIG DATA: A TOOL FOR INCLUSION OR EXCLUSION?, at i, (2016), https://www.ftc.gov/system/files/documents/reports/big-data-tool-inclusion-or-exclusion-understanding-issues/160106big-data-rpt.pdf [https://perma.cc/R44Z-P4P5].

3. In previous publications, Frank Pasquale has examined "incrementalist" fintech, which utilizes technology to provide standard financial services, and "futurist" fintech, in which the entire financial system is remade due to distributed technologies. *See Exploring the Fintech Landscape: Hearing Before the S. Comm. on Banking, Hous. & Urb. Affs.*, 115th Cong. (2017) (statement of Frank Pasquale, Professor of Law, University of Maryland). I use the term "fintech firms" to refer to nondepository financial services firms that integrate artificial intelligence technology and predictive analytics into their business models. While there is no universally adopted definition for the term "fintech," many use the term as a catchall for a broader group of financial services firms that integrate a diverse body of technologies and engage in digital transfers, storage, payments systems, and lending, as well as the origination of virtual currency and robo-advising. *See, e.g.*, Rory Van Loo, *Making Innovation More Competitive: The Case of Fintech*, 65 UCLA L. REV. 232, 238–40 (2018).

4. *See infra* Part I.A.

5. *See infra* Part II.A.

6. *See, e.g.*, E. GERALD CORRIGAN, FED. RSRV. BANK OF MINNEAPOLIS, ARE BANKS SPECIAL?: ANNUAL REPORT 1982 (1982) (raising fundamental questions regarding the role of banks and discussing their prudential regulation).

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

in digital transfers, storage, payments systems, digital asset origination (such as cryptocurrency) and secondary market trading, investment advising and digital credit scoring and origination.

To capitalize on economic efficiencies, reduce transaction costs and mitigate commonly-identified enterprise risks, fintech firms integrate artificial intelligence technologies such as supervised or unsupervised machine learning, deep learning or neural networks ("AI") or distributed ledger technologies into their business models. While there is no universally adopted definition of AI, the term refers to a diverse, but related, set of technologies that train through a reinforcement learning process, simulate human decision-making and cognitive behavior and engage in predictive analysis.[7]

Financial product developers and financial service providers have long engaged statistical and probabilistc models as well as predictive analytics to forecast performance.[8] So fintech is not entirely new. However, sometimes a change in quantity can amount to a change in quality. That may be happening in fintech now, as the inclusion of increasingly comprehensive databases, along with new methods of analysis, means that many fintech firms deploy extremely complex algorithms (including assemblages of earlier models) to predict the likelihood of repayment and profitability of customers.[9] According to some futurists, financial markets' automation will substitute increasingly sophisticated, objective, analytical model-based assessments of, for example, a borrower's creditworthiness, for direct human evaluations are irrevocably tainted by bias and subject to the cognitive limits of the human brain.[10] However, even if they do occur, such advances may violate other legal principles.[11]

How might fintech firms accomplish such a lofty goal? Early fintech firms promising to better integrate underresourced communities into financial services markets typically introduced digital money transfer services that facilitated cash distributions among users (such as PayPal, Apple Pay, or Venmo)[12] and credit platforms that offered digitally-distributed consumer loans. Money

---

7. Examples of AI modeling techniques include but are not limited to decision trees, random forests, artificial neural networks, k-nearest neighbors, genetic programming, and "boosting" algorithms. Given the limited time available and suggested scope, only an abbreviated description of artificial intelligence and other referenced technologies appears in the submitted written testimony.

8. ANTHONY SAUNDERS & MARCIA CORNETT, FINANCIAL INSTITUTIONS MANAGEMENT: A RISK MANAGEMENT APPROACH 97–103 (9th ed. 2017).

9. Note that customers who are late with payments may be much more profitable than a traditionally good credit risk, since they will be paying more in interest and fees.

10. OECD, FINANCIAL MARKETS, INSURANCE AND PENSIONS: DIGITALISATION AND FINANCE 10–13 (2018), https://www.oecd.org/finance/private-pensions/Financial-markets-insurance-pensions-digitalisation-and-finance.pdf.

11. *See, e.g.*, Odia Kagan, *Finnish DPA Orders Company to Modify Automated Creditworthiness Assessment, Improve Disclosures*, FOX ROTHSCHILD (Apr. 27, 2019), https://dataprivacy.foxrothschild.com/2019/04/articles/european-union/finnish-dpa-orders-company-to-modify-automated-creditworthiness-assessment-improve-disclosures/ [https://perma.cc/3K55-8MXN] (reporting that the Finnish Data Protection Authority ordered a firm to "provide individuals with information on the logic behind the decision-making process, its relevance to the credit decision and its consequences for the borrower" pursuant to the General Data Protection Regulation's provisions guaranteeing a right to an explanation).

12. Adam Levitin, *Pandora's Digital Box: The Promise and Perils of Digital Wallets*, 166 U. PA. L. REV. 305, 335 (2018).

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

transmission services can provide vital peer-to-peer platforms for those who lack access to conventional bank branches or personal checking and savings accounts.

Over the last decade, federal banking regulators signaled and adopted policies that preempted state regulatory authority over fintech firms. In the summer of 2018, the Office of the Comptroller of the Currency (OCC) announced its intention to allow fintech firms to apply for special purpose charters that would permit fintech firms to operate, in many respects, as national banks.[13] Consistent with a decades-long campaign to expand the scope of its authority, the OCC's seemingly innocuous announcement reflects the agency's increasingly aggressive interpretation of the scope of its statutory mandate.[14] In previously published research co-authored with Frank Pasquale and Jennifer Chapman, I explain that the OCC's decision may create gaps in the supervision of fintech firms and encourage market participants to engage in regulatory arbitrage.[15] The OCC's special purpose charters may also enable fintech firms to minimize their exposure to state antidiscrimination and consumer protection regulations. Reducing regulatory oversight of these important legal and ethical norms in a dynamic and evolving market defined by a technology that may import unconscious biases and disadvantage lower-income individuals and families raises red flags.

In attempting to enter into the financial services ecosystem, fintech firms typically adopt one of several approaches: offer a digital-only services platform that provides financial services directly to consumers,[16] partner platforms with entities that have a charter or license to operate as a bank,[17] or merge with or acquire a licensed banking entity.[18]

The group of firms operating in the first category ("digital-only services platform that provides financial services directly to consumers") face significant limits in providing financial services and may often endure the costs and challenges of applying state-by-state for operating licenses. These entities also face the continuing, and sometimes conflicting, compliance obligations based on state mandated disclosure or reporting obligations. The second category of fintech firms interpose themselves between consumers and regulated financial institutions, typically providing a service associated with the business of banking. Fintech firms acting as intermediaries may enter into exclusive partnership arrangements, leveraging the integration of technology and the regulated financial institution's established reputation, relationships, and expertise. Perhaps most

13. News Release, Off. of the Comptroller of the Currency, OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies (July 31, 2018), https://www.occ.gov/news-issuances/news-releases/2018/nr-occ-2018-74.html.

14. *See infra* Part II.

15. Kristin Johnson, Frank Pasquale & Jennifer Chapman, *Artificial Intelligence, Machine Learning, and Bias in Finance: Toward Responsible Innovation*, 88 FORDHAM L. REV. 499, 512–51 (2019).

16. For example, Rocket Mortgage is an end-to-end, online mortgage lending platform operated by Quicken Loans, a nonbank mortgage originator. *See* ROCKET MORTGAGE BY QUICKEN LOANS, https://www.rocketmortgage.com/ [https://perma.cc/RY54-LP98] (last visited Aug. 15, 2019).

17. GreenSky is a consumer credit platform that pairs consumers seeking to purchase retail goods or certain services with credit and financial institutions licensed to originate and distribute consumer loans. *See* GREENSKY, https://www.greensky.com [https://perma.cc/U93E-8VLG] (last visited Aug. 15, 2019).

18. SoFi, a fintech lender, recently acquired a bank. *See* Peter Rudegeair, *SoFi Is Buying a Community Lender to Speed Up Banking Expansion*, WALL ST. J. (Mar. 9, 2021, 7:00 PM), https://www.wsj.com/articles/sofi-is-buying-a-community-lender-to-speed-up-banking-expansion-11615291202.

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

importantly, platforms partnering with or consolidating with regulated financial institutions attain the privileges and benefits from their affiliation with federally chartered banking institutions.

In accord with the distinct design of our nation's "dual banking system," both federal and state regulators have the power to issue bank charters.[19] Banks that receive state charters are subject to the day-to-day supervision of state banking regulators[20] but cannot evade federal regulation. Federal regulators supervise federally chartered banks and, to mitigate the challenges of complying with dual—and, at times, incongruent—regulatory obligations, federally chartered banks need only comply with limited state regulatory mandates.[21]

The National Bank Act (NBA) authorizes the OCC to issue federal bank charters to qualifying financial institutions.[22] The statutory language of the NBA grants the OCC broad authority to introduce regulations associated with issuing charters[23] and to determine licensing criteria.[24] In 2003, the OCC amended the regulations governing its authority to issue charters ("2003 Amendments"), creating a path for the agency to issue special purpose national bank (SPNB) charters to nondepository firms.[25] To receive an SPNB charter, however, an entity must be engaged in the "business of banking," meaning the firm conducts at least one of the following core banking functions: receiving deposits, paying checks, or lending money.[26]

For a decade following the 2003 Amendments, the OCC's newly promulgated authority lay dormant. In 2016, the OCC published a white paper exploring the regulatory impact of emerging fintech firms.[27] And, in December 2016 at an event at the Georgetown University Law Center,

19. *See generally* COMPTROLLER OF THE CURRENCY, NATIONAL BANKS AND THE DUAL BANKING SYSTEM (2003), https://www.occ.treas.gov/publications-and-resources/publications/banker-education/files/pub-national-banks-and-the-dual-banking-system.pdf [https://perma.cc/CT4Z-TFB3].

20. *Id.* at 1.

21. *Cuomo v. Clearing House Ass'n*, 557 U.S. 519, 535–36 (2009) (holding that states cannot informally subpoena national banks in "capacity as supervisor[s] of corporations").

22. *See* 12 U.S.C. §§ 21, 26–27 (2012). The collective versions, amendments, and regulations commonly referred to as the "National Bank Act" originated with the National Bank Act of 1863, ch. 58, 12 Stat. 665. This Essay describes the collection of versions, amendments, and regulations as the "National Bank Act."

23. 12 U.S.C. § 26.

24. *Id.* The NBA grants the OCC authority to prescribe rules and regulations to carry out its responsibilities associated with issuing charters. *Id.* Under the NBA, "upon careful examination of the facts," the comptroller of the currency will determine if an applicant for a national banking charter "is lawfully entitled to commence the business of banking" and issue "a certificate" indicating that the business has complied with the standards required for firms engaged in the business of banking. *Id.* § 27.

25. 12 C.F.R. § 5.20(e)(1) (2019).

26. *Id.* Under the "bank powers clause," in section 24 (Seventh) of the NBA, the OCC has the authority to charter national banking associations by granting them "all such incidental powers as shall be necessary to carry on the business of banking" and then listing five express powers. 12 U.S.C. § 24 (2012). The express powers of national banks under section 24 (Seventh) include "(1) discounting and negotiating notes; (2) receiving deposits; (3) trading currency; (4) making loans on personal security; and (5) circulating notes." *Id.* The terms "incidental powers" and the "business of banking" are not expressly defined in the NBA, but include activities authorized at the discretion of the Comptroller, within reasonable bounds. *See* 12 U.S.C.§§21, 24 (Seventh), 26-27 (2012).

27. OCC, SUPPORTING RESPONSIBLE INNOVATION IN THE FEDERAL BANKING SYSTEM: AN OCC PERSPECTIVE (2016), https://www.occ.gov/publications-and-resources/publications/banker-education/files/pub-responsible-innovation-banking-system-occ-perspective.pdf [https://perma.cc/7CQD-QWYZ]. The OCC published supplements to the white paper, requests for comments, and additional white papers following the March 2016 white paper. *See* OCC, EXPLORING SPECIAL PURPOSE NATIONAL BANK CHARTERS FOR FINTECH COMPANIES (2016), https://www.occ.treas.gov/topics/responsible-innovation/comments/pub-special-purpose-nat-bank-charters-fintech.pdf [https://perma.cc/MVX9-ZXJM] [hereinafter EXPLORING SPNBs]; OCC,

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

then-Comptroller Thomas Curry announced the OCC's decision to "move forward with chartering financial technology companies that offer bank products and services."[28]

As a result of the OCC's decision to move forward, each class of fintech firms (digital-only platforms or platforms partnering with banks) may apply for an SPNB charter.[29] While subject to federal regulatory oversight, fintech firms that receive an SPNB charter may be exempt from state regulations that the OCC concludes prevent or significantly interfere with the exercise of banking powers authorized under federal law.[30]

According to the OCC, enabling fintech firms to apply for SPNB charters levels the playing field between fintech firms and conventional depository banks, promotes uniform eligibility criteria, and ensures consistency in the development and enforcement of legal standards across the increasingly diverse body of entities providing financial services. The OCC also boasts that the breadth and depth of federal expertise in banking and risk management oversight, the benefits of federal insurance on deposits and national banks' safety and soundness (e.g., "contingency" plan development), and ethical obligations (to increase inclusion and fair access to financial markets) leave little room to challenge the OCC's decision to preempt state financial services regulators' supervision of fintech firms. Proponents argue that the absence of federal oversight will spur a race to the bottom, as states compete to attract fintech firms to their jurisdiction. This account is, however, misleading.

In July of 2020, I joined a group of dozens of law professors led by Arthur Wilmarth of George Washington University Law School, Morgan Ricks of Vanderbilt Law School, Lev Menand of Columbia Law School, and Joseph Sommer, who practiced at the Federal Reserve Bank of New York for 30 years and has written on fintech, payments, bank insolvency, and bank history in submitting an amicus brief in litigation before the United States Court of Appeals. In the brief, we explain that we are teachers and students of banking law, interested in ensuring that banking agencies operate within their statutory mandates and work in the public interest, rather than the interest of any particular industry.

The amicus brief supports positions adopted by the New York Department of Financial Services and rejects the OCC's attempts to dramatically expand its authority. As we note in the brief, "the

---

RECOMMENDATIONS AND DECISIONS FOR IMPLEMENTING A RESPONSIBLE INNOVATION FRAMEWORK (2016), https://www.occ.gov/topics/responsible-innovation/comments/recommendations-decisions-for-implementing-a-responsible-innovation-framework.pdf [https://perma.cc/4T8U-C5KU] [hereinafter EXPLAINING SPNB CHARTERS]; *Public Comments on Exploring Special Purpose National Bank Charters for Fintech Companies*, OFF. COMPTROLLER CURRENCY, https://web.archive.org/web/20190221152812/https://www.occ.treas.gov/topics/responsible-innovation/fintech-charter-comments.html [https://perma.cc/8FJQ-L48K]. The OCC published a draft supplement to the Comptroller's Licensing Manual signaling that the agency planned to permit fintech firms that do not receive deposits (nondepository entities) to apply for SPNB charters. *See* OCC, EVALUATING CHARTER APPLICATIONS FROM FINANCIAL TECHNOLOGY COMPANIES (2017), https://www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf [https://perma.cc/Q6PW-SSFN]; Press Release, Office of the Comptroller of the Currency, *supra* note **Error! Bookmark not defined.**.

28. Thomas J. Curry, Comptroller of the Currency, Remarks at the Georgetown University Law Center Regarding Special Purpose National Bank Charters for Fintech Companies (Dec. 2, 2016), https://www.occ.treas.gov/news-issuances/speeches/2016/pub-speech-2016-152.pdf.

29. Press Release, Office of the Comptroller of the Currency.

30. 12 U.S.C. § 25b(b).

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

OCC ... conflate[s] banks' permissible activities with their essential activities. While banks are permitted to conduct a wide range of financial activities, the OCC does not have the power to charter entities that are not in the deposit—that is, money creation—business. Once upon a time, the OCC recognized this limitation.[31] We posit that "the OCC's new position contravenes the National Bank Act ("NBA"), the organic statute governing the OCC and national banks, and runs counter to its purpose. It is also inconsistent with the federal banking law in which the NBA is embedded, including the Federal Deposit Insurance Act, the Bank Holding Company Act, and the Federal Reserve Act, the last of which it would undermine by giving nondepository companies that play no role in monetary policy direct access to, and governance rights over, our nation's central bank."

Simply stated, the OCC lacks the authority to charter nondepository national banks. Lev Menand and Morgan Ricks poignantly note that "nondepository national bank" is an oxymoron. As the amicus brief explains,

> The purpose of the NBA's framers is reflected unambiguously in the statute's text. U.S.C. § 27(a), adopted by Congress in 1978, empowers the OCC to charter *nondeposit trust companies*. If the OCC already possessed the general power to charter nondepository entities, that amendment was redundant. Under the canon against surplusage, e.g., *Duncan v. Walker*, 533 U.S. 167, 174 (2001), and the associated canon of *expressio unius est exclusio alterius*, the OCC's claim of unrestricted authority to issue nondepository charters must be rejected.[32]

In other words, we note that the OCC lacks the authority to charter nondepository national banks. As the amicus brief notes,

> 12 U.S.C. § 24 (Seventh) describes the enumerated powers of national banks. Section 24 (Seventh) authorizes national banks "to exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes." Inconveniently for the OCC, Section 24 (Seventh) uses the conjunctive "and," suggesting that all the enumerated activities are required or, at the very least, that not all of them are optional. The NBA's monetary purpose, discussed above, confirms beyond any doubt that depository activities are required... four statutes, together with the NBA, embody most of the U.S. law of money and banking. They are (1) the Federal Deposit Insurance Act (FDIA), (2) the Bank Holding Company Act (BHCA), (3) the Banking Act of 1933, and (4) the Federal Reserve Act (FRA),. Those statutes define the business of banking in terms of deposit-taking or are

31. Reply Br. for the Fed. Pet., Robert L. Clarke, Comptroller of the Currency, in Clarke v. Sec. Indus. Ass'n, 479 U.S. 388 (1987), 1986 WL 728049, at *5–6 (identifying "depository . . . services" as an "essential attribute[]" of the "business of banking").

32. See also *Indep. Ins. Agents of Am. v. Hawke*, 211 F3d. 638, 641-45 (D.C. Cir. 2000) (statutory authorization for national banks to sell insurance in towns with populations not greater than five thousand precludes national banks from selling crop insurance in larger communities); *Am. Land Title Ass'n v. Clarke*, 968 F.2d 150, 155-57 (2d Cir. 1992) (similarly holding that national banks cannot sell title insurance in larger communities), cert. denied, 508 U.S. 971 (1993).

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

written in ways that do not make sense in a world that includes all manner of nondepository national banks. Those statutes are in pari materia with the NBA. The OCC's scheme would also disrupt monetary policymaking and upset the competitive balance in the nonbank financial sector by giving technology firms direct access to Fed services as well as a say in Fed governance.

FDIC Proposed ILC Rule

Industrial loan companies began as small state-chartered banks in the early 1900s, offering financial services to industrial workers – a niche market servicing a population that had limited access to commercial banking, and more specifically credit, services. Over the last century, ILCs have performed an important role in the financial services markets. The Garn-St. Germain Depository Institutions Act adopted in 1982 expanded eligibility for Federal deposit insurance protection to industrial banks and brought industrial banks under the supervision of both a State authority and the FDIC.

The Federal Deposit Insurance Act consequently provides that industrial banks are "state banks" and all of the existing FDIC-insured industrial banks are "state nonmember banks."[33] In 1987, Congress enacted the CEBA, which exempted industrial banks from the definition of "bank" in the BHCA. As a result, parent companies that control industrial banks are not BHCs under the BHCA and are not subject to the BHCA's activities restrictions or FRB supervision and regulation. The industrial bank exception in the BHCA therefore allows for commercial firms to own or control a bank.

Read together the statutes and amendments establish that ILCs are state-chartered banks that have direct access to the federal safety net--deposit insurance and the Federal Reserve's discount window and payments system--and have virtually all of the deposit-taking, lending, and other powers of a full-service commercial bank. As Scott Alvarez, the Federal Reserve Board's former General Counsel, explained to this Committee in his testimony before this committee over a decade ago:

> Despite their access to the federal safety net and broad powers, these banks operate under a special exception to the federal Bank Holding Company Act (BHC Act). This special exception allows any type of firm, including a commercial firm or foreign bank, to acquire and operate an ILC chartered in one of a handful of states outside the framework of federal supervision of the parent holding company and without the restrictions on the scope of activities conducted by the ILC's affiliates that govern the ownership of insured banks by bank holding companies. [34]

[33] Parent Companies of Industrial Banks and Industrial Loan Companies, 86 Fed. Reg. 10703, 10704 (Feb. 23, 2021) (to be codified at 12 C.F.R. pt. 354).
[34] Scott G. Alvarez, *Industrial loan companies*, BD. OF GOVERNORS OF THE FED. RSRV. SYS. (July 12, 2006), https://www.federalreserve.gov/newsevents/testimony/alvarez20060712a.htm.

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

In general, "any company which has control over any bank" is a bank holding company ("BHC").[35] BHCs are "subject to the [Federal Reserve] Board's regulations and supervisory oversight, which includes examinations, regular financial reporting, capital and liquidity requirements, source of strength obligations, activities restrictions, and restrictions on affiliate transactions."[36]

The Bank Holding Company Act defines a bank as either an insured bank or an entity that accepts demand deposits and makes commercial loans.[37] ILCs receive federal safety-net deposit insurance, and would satisfy the BHCA definition of bank. However, the BHCA explicitly excludes ILCs from the BHCA definition of bank,[38] thus excluding their holding companies from consolidated Fed supervision and restrictions on their activities.

The lack of activity restrictions along with the lack of consolidated supervision threatens the separation of banking and commerce that is a general feature of the US banking system. In addition, critics of the ILC loophole argue that:

> Many existing industrial banks are captive lenders for their commercial and industrial parents. They provide loans to promote the sale of their parents' goods and services. They are not, and could never be, objective and impartial providers of credit. If we allow commercial and industrial firms to acquire more captive banks, the result will be an increasingly skewed allocation of credit across our economy.[39]

Weakness in the (unrestricted, unsupervised) ILC parent could threaten the safety and soundness of the ILC. A common example is that of GMAC, which was GM's ILC. GMAC required a $17 billion bailout and had to convert into a bank holding company.[40]

GM's deteriorating financial condition throughout the early 2000s "caused GMAC's credit rating to be lowered to junk status," increasing the cost of capital to GMAC and interest costs to GMAC's borrowers.[41] GMAC had also become active in the mortgage market and thus was exposed to the housing bust and declines in auto sales.[42] While Dodd-Frank now requires ILC parents to serve as

35. 12 USC 1841(a)(1).
36. Control and Divestiture Proceedings, 85 Fed. Reg. 12398, 12399 (Mar. 2, 2020) (to be codified at 12 C.F.R. pts. 225 and 228), https://www.federalreserve.gov/aboutthefed/boardmeetings/files/control-rule-fr-notice-20200130.pdf (footnotes omitted).
37. 12 USC 1841(c)(1).
38. 12 USC 1841(c)(2)(H).
39. Arthur E. Wilmarth Jr., Opinion, *Beware the return of the ILC,* AM. BANKER (Aug 2, 2017, 3:28 pm), https://www.americanbanker.com/opinion/beware-the-return-of-the-ilc.
40. *Id.*
41. BAIRD WEBEL & BILL CANIS, CONG. RSCH. SERV., R41846, GOVERNMENT ASSISTANCE FOR GMAC/ALLY FINANCIAL: UNWINDING THE GOVERNMENT STAKE 4 (2015), https://fas.org/sgp/crs/misc/R41846.pdf.
42. *Id.* at 5.

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

a source of strength to the ILCs they control, it is unlikely that a failing GM could have served as a source of strength to GMAC. Just over a decade after that experience, GM is once again planning to acquire an ILC.[43]

Further, Rakuten, known as the "'the Amazon.com of Japan,'"[44] is currently attempting to form an ILC.[45] The ILC exception allows a company such as Rakuten (or GM), which otherwise would not be allowed to control a bank, to control an ILC, which is functionally equivalent to a bank, without restrictions on its commercial activities and without consolidated supervision that BHCs are subject to. Press reports suggest that a potential approval of Rakuten's application and the FDIC's final ILC rule could allow large US technology companies into the banking realm.[46]

In addition to the OCC's SPNB and the FDIC's final ILC rule, the OCC's true-lender rule may also permit fintechs to charge consumers excessive interest rates. The true-lender rule establishes "a bank makes a loan when it, as of the date of origination, (1) is named as the lender in the loan agreement or (2) funds the loan."[47] This rule is partly in response to situations where a "loan is originated as part of a lending partnership involving a bank and a third party."[48] In essence, the rule allows a bank to be the true-lender by being named on the loan agreement as of the origination date. This effectively allows the loan to circumvent any state interest rate caps.[49] The OCC acknowledges that commentators have raised concerns that the true-lender rule "facilitates inappropriate 'rent-a-charter' lending schemes—arrangements in which a bank receives a fee to 'rent' its charter and unique legal status to a third party." [50] While acknowledging these concerns, the OCC observes that "[t]hese arrangements have absolutely no place in the federal banking system."[51] Yet, the final rule effectively legitimizes these arrangements.

Taken together, the OCC's SPNB, the FDIC's permissiveness towards ILCs, and the OCC's true-lender rule all serve to undermine state usury laws. Because "a combination of federal and state

---

[43] Orla McCaffrey & Mike Colias, *GM Plans to Seek Banking Charter to Grow Auto-Lending Business*, WALL ST. J. (Nov. 27, 2020, 1:19 pm), https://www.wsj.com/articles/gm-plans-to-seek-banking-charter-to-grow-auto-lending-business-11606501125.

[44] Arthur E. Wilmarth, Jr. *The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks*, 39 BANKING & FIN. SERVS. POL'Y REP. 1, 1–2 (2020).

[45] *Rakuten files third application for FDIC insurance*, JD SUPRA (Jan. 26, 2021), https://www.jdsupra.com/legalnews/rakuten-files-third-application-for-8039599/.

[46] Jesse Hamilton, *FDIC Eases Path for Amazon and Facebook to Become Lenders*, Bloomberg (Dec. 15, 2020, 12:47 pm), https://www.bloomberg.com/news/articles/2020-12-15/wall-street-faces-prospect-of-amazon-bank-as-fdic-eases-path.

[47] National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68742, 68742 (Oct. 30, 2020) (to be codified at 12 C.F.R. pt. 7), https://www.occ.gov/news-issuances/federal-register/2020/85fr68742.pdf ("True-Lender Rule").

[48] *Id.*

[49] Raul Carrillo, *Examining "Banking Innovation or Regulatory Evasion?: Exploring Trends in Financial Institution Charters"* Thursday, April 15, 2021.

[50] True-Lender Rule at 68742.

[51] *Id.*

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

law changes eliminated rate caps for most banks," fintechs can now (depending on the outcome of the SPNB litigation), either charter SPNBs or ILCs to charge consumers excessive interest rates. Failing that, a fintech can enter into a partnership with a bank which, with the protection afforded by the true-lender rule, can (in name only) originate an excessively high interest loan then immediately assign it to the fintech company.

Expanding Bank Charter Offerings Without Sufficient Guardrails Raises Significant Consumer Protection, Fairness, and Safety and Soundness Concerns

Alternative Data

Supplementing traditional credit underwriting data inputs and processes, fintech firms employ newer modeling techniques and consider a broader range of source data referred to descriptively (rather than normatively) as alternative data. These new inputs include information regarding consumers' financial transactions, recurring payments history and a behavioral score based on social networking and digital-interface. Fintech firms include both the non-depository digital platforms that operate independently and platforms that partner with legacy banks to originate loans.[52] Fintech firms servicing credit scoring and underwriting markets offer great promise but also present unique concerns.[53]

The introduction of alternative data may improve access to credit for many consumers with nonexistent or insufficient credit histories. According to estimates, twenty-six million Americans do not have traditional credit histories and are considered "credit invisible." Another nineteen million Americans have thin (limited), impaired or stale (outdated) credit histories and, as a result, cannot obtain credit scores using traditional scoring methodologies ("credit unscorable").

Unsavory lending practices, detestable marketing tactics and usurious interest rates have too often plagued marginalized consumers who face persistently fragile financial circumstances.[54] Unlike legacy credit scoring businesses such as Equifax, Experian and Transunion that rely on commercially available credit scoring models like the Fair Isaac Corporation Lenders ("FICO") methodology fintech firms increasingly rely on alternative credit scoring models and nontraditional source data. According to proponents, the development of nascent methodologies and alternative data enables fintech firms to expand access to credit to consumers historically deemed invisible or unscorable.

[52] Christopher K. Odinet, *Consumer Bitcredit and Fintech Lending*, 69 ALA. L. REV. 781 (2018)
[53] FED. TRADE COMM'N, BIG DATA: A TOOL FOR INCLUSION OR EXCLUSION?, at i, (2016).
[54] Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1261 (2002).

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

Legislative and regulatory authorities must, however, balance fintech firms' laudable promises of greater inclusion with the significant risks posed by integrating alternative data and new methodologies. Careful examination of the rise of alternative data and the evolution in consumer credit underwriting methods casts a spotlight on fintech firms' promises of inclusion and reveals the perils of relying on source data that may not be demonstrably predictive of creditworthiness as well as the potential for predatory or discriminatory practices to undermine the anticipated benefits of alternative source data and credit evaluation processes.

Fintech firms integrating alternative data and modeling techniques must satisfy long-standing fairness and accountability standards, engage in responsible innovation and commit to provide sufficient transparency, meaningful disclosure, auditing and necessary internal controls to meet statutory obligations regarding their methodologies and minimize the potential for discriminatory effects on legally protected classes.

Advancements in the collection, storage and analysis of vast volumes of data ("big data") fuel AI platforms designed to automate decision-making in several key sectors including healthcare, education, employment, criminal law, security, surveillance, communications and finance. While the inclusion of data crunching algorithms is nothing new – investment banking firms, for example, have long relied on sophisticated algorithms to predict timing, pricing, risk and other factors that influence investment and trading decisions - the rapid adoption of learning algorithms that interpret alternative data in consumer credit markets presents significant risks.

Automating Credit Decisions

Learning algorithms at the center of fintech platforms' credit evaluation processes analyze vast quantities of data in fractions of a second. Fintech platforms replace face-to-face meetings with loan officers and cumbersome and time-consuming paper-based credit application processes with applications accessible on internet-enabled smartphones, tablets and other mobile or personal devices. Removing human underwriting agents and their biases arguably reduces the likelihood of intentional discrimination. AI-based credit scoring methodologies may enhance consumer default predictions and lead to better credit classification and possibly lower-priced credit than traditional credit scoring methodologies. Together these process-oriented improvements enhance efficiency and accuracy, improve pricing, reduce operating and loan origination costs and enable fintech firms to offer credit to a greater diversity of consumers, in particular those who have struggled to obtain credit.

Traditional credit evaluation processes like FICO consider tradeline information, including but not limited to existing and previous loan obligations, repayment history, credit limits, account status for revolving accounts, credit inquiries, public records such as civil judgments, tax liens and bankruptcies. Incumbent credit scoring methodologies predominantly use multivariate regression analysis to correlate past credit history to consumer credit outcomes and evaluate the likelihood of default or delinquency. Increasingly, incumbent credit scoring firms and traditional methodologies

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

are shifting their evaluation criteria. As fintech firms tout the benefits of AI driven decision-making, both incumbent credit scoring firms and insurgent fintech platforms rely on alternative sources of data and scoring methodologies.

According to industry and federal and state agency reports, alternative data refers to information not traditionally used by the national consumer reporting agencies ("CRA") in calculating a consumer's credit score. In some instances, alternative data simply expands the categories of payment history beyond those considered by CRAs. For example, some fintech platforms integrate telecommunications (mobile phone and cable bills), utilities or residential rental payment history. In other instances, fintech firms expand the types of information considered in credit scoring processes and include financial transaction data (checking account cashflows).

Alternative data may assist historically marginalized (credit invisible and unscorable consumers) to gain access to conventional credit markets. There is good reason to believe that capturing nontraditional data may enable consumers with thin, impaired or nonexistent credit files to demonstrate a history of timely bill payment. The frequency of telecommunications, utility and rental payments may enable consumers to generate a different but valuable track record or consistent, timely bill payment history.

Limitations and conflicts arising from the use of alternative data to expand access to credit. Consumer advocates have, however, expressed some concerns regarding the impact of integrating certain data points, such as utility bill payments. Relying on utility or cable bill payment histories may disadvantage low-income consumers for various reasons. First, dispute resolution processes for public utilities and cable services may differ from other types of recurring obligations. Second, utility bill balances may fluctuate seasonally, prompting some consumers to delay payments or fall behind on pay utilities bills. Low-income or fixed income families are particularly susceptible to these circumstances.

Consider, for example, the families living in areas of the country that face severe seasonal weather patterns. For families living in the northeastern part of the country, for example, home heating bills may present significant monthly demands during the winter and families may not be able to pay utility bills on-time or in full at the close of each billing cycle. Similar challenges may arise for families living in southern states during the summer months. Finally, the significance assigned to recurring residential bills may disadvantage families that migrate seasonally based on employment opportunities or periodically relocate based on service in the armed forces.

Financial transaction and social networking data. Expanding credit evaluation criteria beyond additional types of recurring payments, alternative data may also include personal consumer financial transaction data – bank account and credit/debit card transactions, including deposits, transfers or withdrawals. Methodologies integrating alternative data may also incorporate educational (major and university attended) or professional accomplishments.

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

Proponents of alternative data also advocate for the inclusion of nonfinancial, behavioral data. These data points may include digital interface information such as clickstream data, audio and text data, internet browsing and search habits, geo-spatial data and survey or questionnaire data.[55] Beyond simply browsing preferences, fintech firms are also integrating highly-personalized reputational data. For example, fintech firms are assessing consumers' social network status, web-scraping data from consumers' financial transactions and social media activities and ranking consumers based on relational social connections (consumers' status as "social influencers") through analysis of exchanged messages and friends tagged in social media posted photos.

It is not yet clear how these new sources of data will impact those without credit reports or with thin or stale credit files. It is also unclear how credit invisibles and unscorables who do not have conventional checking and savings accounts or credit cards will generate financial transaction data. Similarly, ranking consumers based on higher educational or professional accomplishments seems likely to replicate the current credit scoring patterns. Finally, credit invisibles and unscorables that lack a presence on social media are unlikely to engender the relational benefits or rewards associated with social networking. In fact, familial and neighborhood associations may make it more difficult for consumers who have not traditionally qualified for credit on fair and reasonable terms to gain access to better, higher quality credit products.

Indisputably, however, the rising significance of alternative data has ignited interest across various markets for greater access to consumer financial data. Consistent with its dominance in the general technology market, Facebook has directly approached banks requesting access to consumers' financial transaction data[56] and registered for a patent for a technology that assesses users based on social network connections. Technology firms often seek to gather sensitive data from consumers but resist transparency regarding the uses of consumer data.[57]

Regulating Alternative Data

The harvesting, distribution and integration of financial transaction and behavioral scoring data raises significant questions regarding consumer protections, privacy and discriminatory practices. Alternative data such as financial transaction data - credit and debit card and checking account transaction history- may offer valuable insights. Information regarding financial transaction activities and behavior may better inform evaluations of factors that are correlated to consumer credit risk assessment. A consumer's financial history is, however, sensitive information. Unmonitored use and distribution of this information challenges consumer protections and privacy norms.

Privacy Concerns – Existing and Proposed Federal Oversight

[55] Mikella Hurley and Julius Adebayo, *Credit Scoring in the Era of Big Data*, 18 YALE J. L. & TECH. 148, 159 (2016).
[56] Emily Glazer, Deepa Seetharaman and AnnaMaria Andriotis, *Facebook to Banks: Give Us Your Data, We'll Give You Our Users*, WALL ST. J., Aug. 6, 2018.
[57] FRANK PASQUALE, THE BLACK BOX SOCIETY (Harvard Univ. Press, 2015).

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

A host of state and federal regulators and this Committee are actively seeking to clarify the types of alternative data and the method for including these new class of information in emerging and evolving credit scoring processes. This Committee has held multiple hearings to explore these questions.

More specifically, in February of 2017, the Consumer Financial Protection Bureau ("CFPB") announced a comprehensive Request for Information Regarding Use of Alternative Data and Modeling Techniques in the Credit Process. The Government Accountability Office ("GAO") issued a report in March of 2018 - *Additional Steps by Regulators Could Better Protect Consumers and Aid Regulatory Oversight* - and a second report in December of 2018 - *Agencies Should Provide Clarification on Lenders' Use of Alternative Data* – recommending a series of policies including proposals to coordinate agencies' regulatory efforts, clarify standards governing alternative data and minimize uncertainty regarding the use of alternative data in the underwriting process. In the absence of effective state or federal regulatory intervention, many warn that fintech firms will take advantage of gaps in oversight and engage in regulatory arbitrage.

Advocates argue that existing regulations sufficiently address consumer protection, privacy and antidiscrimination concerns. Under the Gramm Leach-Bliley Act, financial institutions may not distribute "raw" consumer data to third parties; instead, prior to distributing consumers' personal financial data, financial institutions must aggregate, anonymize and de-identify personalized transaction details. Financial institutions must also send consumers initial and annual privacy notices and allow them to opt-out of sharing their personal transaction information with unaffiliated third parties.

These protections are, however, weak and evidence suggests that they do not effectively protect consumers' confidential personal financial information. Using statistical methods, data scientists can decode or de-anonymize aggregated consumer social media and financial transaction data. In other words, data scientists can reverse the steps taken by financial institutions to de-identify consumer data and match consumer data with individual consumers' profiles. A recent study by Stanford and Princeton researchers details a theoretical methodology for de-identified web browsing histories and linking individual search histories to social media profiles using only publicly available data to facilitate the matching process.[58]

Behavioral scoring presents even more pernicious concerns. According to proponents of behavioral scoring, the likelihood that a consumer will default on payment obligations may be determined by evaluating the consumer's network of friends, neighbors, folks with similar interests, income levels, and backgrounds. Unlike consumer financial transaction data and payment history evaluations, however, behavioral scoring may not be demonstrably predictive of financial responsibility.

---

[58] Jessica Su, Ansh Shukla, Sharad Goel, Arvind Narayanan, *De-anonymizing Web Browsing Data with Social Networks*, Apr. 3, 2017, https://5harad.com/papers/twivacy.pdf.

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

Credit is, indisputably, a critical resource. Individuals and families increasingly rely on credit to finance household purchases or overcome significant, unanticipated expenses.[59] Without access to credit on fair and reasonable terms, it can be extraordinarily expensive to be poor. For families with fragile financial circumstances, credit may serve as a lifeline, enabling consumers to meet short term debt obligations, and to pay for education, housing, and even food.[60]

Consumers navigate an ever-widening web of debt. According to the Federal Reserve Bank of New York's Center for Microeconomics – at the close of the first quarter 2019, families and individuals face over $13 trillion in debt obligations.[61] Rising college and university tuition rates have fueled an increase in educational debt obligations. Students and their families currently owe approximately $1.5 trillion in student loan debt.[62] A parallel narrative in the home mortgage loan market has led American households to borrow over $9 trillion in mortgage debt.[63]

Credit reporting agencies have a special role in financial markets and fintech firms operating at the intersection of startup innovation and consumer credit origination raise a number of the normative questions.[64] As AI increasingly influences the terms and availability of credit, this nascent technology will also inevitably perform a gatekeeping function, determining who receives access to credit, and for those with access, learning algorithms will likely decide the most fundamental terms of any credit arrangement.

Privacy Concerns - Adopted and Proposed State Laws and Regulation

In the absence of definitive federal regulation addressing the use of alternative data, several state laws require disclosure regarding the use of alternative data by credit scoring platforms or limit the use of alternative data.

---

[59] REPORT ON THE ECONOMIC WELL-BEING OF U.S. HOUSEHOLDS IN 2018, BRD. GOVERNORS FED. RESERVE SYS. (2019), https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf.

[60] *See* Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 STAN. L. REV. 1093 (2019) (describing the dangers of making credit a key determinant of whether and how basic needs are met).

[61] QUARTERLY REPORT ON HOUSEHOLD DEBT AND CREDIT (Q1 2019), CTR. MICROECON. DATA: FED. RESERVE BANK N.Y. (2019), https://www.newyorkfed.org/medialibrary/interactives/householdcredit/data/pdf/HHDC_2019Q1.pdf.

[62] *Id.*

[63] *Id.*

[64] E. Gerald Corrigan, *Are Banks Special?:* ANNUAL REPORT 1982, FEDERAL RESERVE BANK OF MINNEAPOLIS (raising fundamental questions regarding the role of banks and prudential regulation).

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

California Consumer Privacy Act. Signed by Governor Jerry Brown on June 28, 2018, the California Consumer Privacy Act ("CCPA") grants a consumer the right to request that a business "disclose the categories and specific pieces of personal information that it collects about ...consumer[s], the categories of sources from which that information is collected, the business purposes for collecting or selling the information, and the categories of [third] parties with which the information is shared."[65] The CCPA also enables consumers to request the deletion of personal information, opt out of the sale of personal information, and access the personal information in a "readily useable format."[66]

The CCPA construes "personal information" broadly. Under the CCPA, "personal information" means "information that identifies, relates to, describes, is capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household."[67] Similarly, the law also offers a broad definition of the term "sell;" consequently, any of the following activities constitutes a sale of consumer data: "disclosing, disseminating, making available, transferring or otherwise communicating orally or in writing or by electronic or other means" a consumer's personal data. Examples of personal information include consumer's personal identifiers, education information, geolocation, biometric data, internet browsing history, psychometric data, and "inferences" drawn from information used to create a profile about a consumer, reflecting the consumer's preferences, predispositions or behavior, among other attributes.

The CCPA requires companies to obtain consent from customers before selling their personal data to third parties, but it does not apply to consumer information that is de-identified. "De-identified" information is personal information that cannot reasonably identify, relate to, describe, or be linked to a particular consumer.[68] In addition, the CCPA does not apply to "aggregate consumer information," which is information that relates to a group or category of consumers, from which individual consumer identities have been removed, that is not linked or reasonably linkable to any consumer or household or device.[69]

Critics have challenged the breadth of the CCPA and the likely impact that the law would have on established business models in the technology sector including several of the largest technology companies such as Facebook, Twitter, and Google.[70] This restriction may extend to internet service providers such as AT&T and Verizon, which collect broadband activity data (web browsing data) and may generate behavioral profiles to enable digital advertising.[71]

---

[65] Assembly Bill No. 375, https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB375.
[66] Dipayan Gosh, *What You Need to Know About California's New Data Privacy Law*, Harvard Business Review (July 11, 2018), https://hbr.org/2018/07/what-you-need-to-know-about-californias-new-data-privacy-law.
[67] Assembly Bill No. 375, https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB375.
[68] *Id.*
[69] *Id.*
[70] *Id.*
[71] *Id.*

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

New York State Senate 2302 and Department of Financial Services Regulatory Guidance

As of July 2019, the New York State Assembly is considering the adoption of Senate bill 2302 - a bill that would prohibit consumer reporting agencies from using information about the members of a consumer's social network to evaluate the consumer's creditworthiness.[72] The bill defines the term "members of a consumer's social network" as "a group of individuals authorized by a consumer to be part of his or her social media communications and network."[73] The bill prohibits consumer reporting agencies from "collect[ing], evaluat[ing], report[ing], or maintain[ing] in the file on a consumer the credit worthiness, credit standing or credit capacity of members of the consumer's social network for purposes of determining the credit worthiness of the consumer; the average credit worthiness, credit standing or credit capacity of the consumer's social network; or any group score that is not the consumer's own credit worthiness, credit standing or credit capacity."[74] In addition to pending legislation limiting the use of social networking behavioral information in consumer credit evaluation processes, New York state financial services regulators have expressly limited the use of alternative data in the context of life insurance underwriting methodologies.

Preventing Redlining: New York State Department of Financial Services Insurance Circular: Use of External Consumer Data and Information Sources in Underwriting for Life Insurance

On January 18, 2019, the New York State Department of Financial Services ("NYSDFS") issued an insurance circular with two guiding principles on the use of alternative data in life insurance underwriting. First, insurers must independently determine that external data sources do not collect or use prohibited criteria. Insurers may not rely on a vendor's claim of that alternative data does not reflect bias or result in discrimination against protected classes. Insurers may not evade their obligations to comply with antidiscrimination laws by pointing to the proprietary nature of a third-party process.[75] Notwithstanding the fact that alternative data may be provided by third-party vendors, the NYSDFS emphasized that "the burden" to ensure compliance with antidiscrimination laws "remains with the insurer at all times."[76]

Second, insurers should not use external data unless they can establish that it is not "unfairly discriminatory."[77] Insurers must be confident that the use of alternative data is demonstrably predictive of mortality risk. The Circular also notes that "transparency is an important

[72] https://legislation.nysenate.gov/pdf/bills/2019/S2302.
[73] *Id.*
[74] *Id.*
[75] *Id.*
[76] https://www.dfs.ny.gov/industry_guidance/circular_letters/cl2019_01
[77] *Id.*

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

consideration in the use of external data sources to underwrite life insurance." Insurers using external data should be confident that the use of the data is demonstrably predictive of mortality risk and that they can explain how and why this is the case.[78]

Fair Credit Reporting – Alternative Data as a "Consumer Report"

The Fair Credit Reporting Act ("FCRA") imposes obligations on CRAs - entities that provide consumer reports - as well as anyone who uses or furnishes information included in consumer reports. The FCRA defines consumer reports as "communication[s] of any information by a consumer reporting agency bearing on a consumer's creditworthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in part for determining a consumer's eligibility for credit, employment purposes, or any other purposes enumerated in the statute."

A number of questions arise as fintech firms begin to gather alternative data and generate credit assessments. If fintech firms' consumer credit assessments based on alternative data constitute "consumer reports," consumers and consumer advocates may assert that fintech firms are subject to the obligations imposed on CRAs under the FCRA. In addition, CRAs may only distribute consumer reports for limited purposes identified in the statute. Consumer reports may be furnished (i) in connection with a credit transaction involving the consumer, (ii) for employment purposes, (iii) in connection with insurance underwriting, or (iv) in accordance with the consumer's written instructions. Consequently, entities gathering data and fintech firms and other firms that obtain and resell data may violate the FCRA by impermissibly using and transferring assessments based on alternative data if such assessments constitute consumer reports. As described in the CFPB request for information and the GAO reports, federal regulators should clarify the contexts in which nontraditional data or alternative data will be deemed "consumer reports" and the instances in which fintech firms may be deemed CRAs.

Adverse Action Notices – Explainability

The FCRA and Equal Credit Opportunity Act ("ECOA") also impose an adverse action notice requirement for entities that take action with respect to any consumer that is based, in whole or in part, on any information contained in a consumer report. State law parallels federal obligations for adverse action notices.

Under relevant provisions of New York Insurance Law referenced above, for example, insurers must notify consumers of their right to receive the "specific reason or reasons for a declination, rate differential, or other adverse underwriting decision." According to the NYSDFS Circular issued earlier this year, if an insurer uses alternative data to underwrite insurance, the reason(s)

---

[78] *Id.*

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

provided to the consumer for any adverse action "must include details about all information" underlying the decision, including the specific source of the information.

Satisfying adverse action notice requirements may present a significant challenge for platforms using learning algorithms to review large volumes of alternative data. The inscrutable and non-intuitive nature of learning algorithms suggests that even developers may be unable to explain the specific rationale underlying an algorithm's credit or insurance underwriting decision.[79] As a result, it may be difficult for CRAs to explain adverse actions as contemplated under the existing regulatory framework.

Bias, Fairness and Inclusion

Under ECOA and federal fair lending regulations, intentional discrimination based on a protected trait is prohibited under antidiscrimination statutes. Facially-neutral algorithms mitigate the risk that consumers will face intentional discriminatory treatment based on legally protected traits such as race, gender or religion; this suggests that fintech firms employing automated decision-making platforms are not likely to engage in intentional discrimination and therefore are less likely to violate antidiscrimination statutes. The operational mechanics of learning algorithms may, however, mask an algorithm's reliance on a trait that functions as a proxy for a legally protected trait.

Evidence demonstrates that incomplete or inaccurate data sets may influence the objectivity of learning algorithms. Perhaps even more alarming, learning algorithms are designed to identify the most expedient path or optimal variable for solving a problem or making a decision. Learning algorithms seek to identify variables that simplify and expedite the sorting, classifying and ranking of identified subjects. To that end, learning algorithms may rely on proxies or traits that are highly-correlated with protected traits.[80]

This approach may result in the learning algorithm relying on facially-neutral variables in a manner that masks prohibited decision-making behavior.[81] In other words, the algorithm may make decisions using facially neutral variables that function as proxies in the decision-making process for prohibited criteria, violating antidiscrimination protections.

Even if developers expressly program algorithm's not to discriminate on the basis of a protected trait, the developers' biases may creep in and influence the algorithm's operation. Three examples illustrate concerns regarding biases in the data sets. First, inaccurate, incomplete and otherwise

[79] Andrew D. Selbst & Solon Barocas, *The Intuitive Appeal of Explainable Machines*, 87 FORDHAM L. REV. 1085 (2019)
[80] Daniel Schwarcz and Anya Prince, *Proxy Discrimination In The Age Of Artificial Intelligence And Big Data*, IOWA L. REV. (*Forthcoming* 2020).
[81] Solon Barocas & Andrew Selbst, *Big Data's Disparate Impact*, 104 CAL. L. REV. 671, 678 (2016).

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

flawed data sets may potentially amplify discrimination.[82] To illustrate this concerns, consider Amazon's attempt to use an automated decision-making platform to evaluate, score and rank job applicants for a software developer position.

Amazon created a resume review platform designed to identify and sort candidates with desirable attributes for a software developer position. The platform received facially- neutral instructions regarding educational or skill prerequisites and analyzed the resumes of employees recently hired for similar computer programmer positions. Beyond this initial data set and series of instructions, the platform taught itself to mimic human-like decision-making behavior. As the platform began to review real candidates' resumes, it operated independently, using cognitive analysis to decide which candidates to interview without specific instructions regarding the submitted resumes.[83]

Amazon's goal was to identify best athletes in a competitive pools of applicants.[84] Notwithstanding programmers' intentions, the platform began to "penalize resumes that included the word 'women's,' as in 'women's chess club captain,'" and "downgraded graduates of. . . women's colleges."[85] Amazon's experiment illustrates the risk that an automated platform will inherit the biases that data sets and developers unknowingly introduce, leading to unanticipated and potentially prohibited discrimination against individuals who are members of a legally protected class.

Second, selecting and cleaning data sets involves human judgment. Data sets are often compiled by third party vendors and distributed to developers who utilize the data to create a training data set. A learning algorithm's successful analysis depends significantly on the data used to train the algorithm.

In order to achieve the predictive benefits of learning algorithms, data sets require a large number of observations. Even if a data set has a sufficient number of observations, the data must be subjected to several pre-processing steps including, among others, cleaning, partitioning, sampling, scaling and feature selection. These steps are necessary because datasets are rarely free from missing or inaccurate values. Data scientists must decide how to resolve missing values. The options for addressing these concerns may include removing the subjects with missing values from the data set and excluding them from the analysis. At each step from data collection decisions to the development of the algorithm, human judgment will influence how the algorithm operates.

---

82 SAFIYA NOBLE, ALGORITHMS OF OPPRESSION (2018); VIRGINIA EUBANKS, AUTOMATING INEQUALITY: HOW HIGH-TECH TOOLS PROFILE, POLICE AND PUNISH THE POOR (2018); Margaret Hu, *Algorithmic Jim Crow*, 86 FORDHAM L. REV. 633 (2017).

83 See Jeffrey Dastin, Amazon Scraps Secret AI Recruiting Tool That Showed Bias Against Women, REUTERS (Oct. 9, 2018), https://www.reuters.com/article/us-amazon-com-jobs-automation-insight/amazon-scraps-secret-ai-recruiting-tool-that-showed-bias-against-women-idUSKCN1MK08G.

84 *Id.*

85 *Id.*

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

Finally, some commentators have demonstrated that underrepresentation, particularly of members of legally protected classes, may lead to digital discrimination.[86]

One study suggests that fintech firms using AI based methodologies are replicating historic biases. According to the results of the study both fintech and traditional mortgage origination firms lending practices result in discrimination against Latinx and African-American borrowers.[87]

Cyber Security Concerns

In addition to privacy and discrimination concerns, permitting fintech firms and CRAs to collect alternative data heightens cybersecurity concerns. The rising cost, frequency, and severity of data breaches now dominate risk management discussions. Over the last ten years, more than 4,000 known data breaches have shocked, debilitated, and even (temporarily) paralyzed markets. Commentators estimate that vast numbers of records containing confidential or sensitive data have been compromised. Experts suggest that data breaches cost the global economy more than $ 400 billion dollars of losses annually.

As cyberattacks multiply, governments, corporations, and citizens scramble to mount a successful defense against cyber-intrusions. The size, sophistication, and diversity of styles of the cyberattacks renders these activities among the most perilous of emerging risk management concerns.

The cyberattacks against financial institutions threaten the stability of financial markets and create personal costs for consumers exposed during data breaches. As the New York State Department of Financial Services noted, "[c]yber hacking is a potentially existential threat to our financial markets." Federal regulators have warned that cybersecurity threats may "wreak serious havoc on the financial lives of consumers."

Financial transaction and social media data present particularly attractive targets for hackers. Pursuant to federal regulation and consistent with their business models, large financial institutions acquire, collect, and retain significant volumes of personal information. Collection, storage and transfer of this sensitive data renders financial institutions and retailers highly attractive targets for hackers.

---

[86] Joy Buolamwini and Timnit Gebru, *Gender Shades: Intersectional Accuracy Disparities in Commercial Gender Classification*, 81 PROCEEDINGS OF MACHINE LEARNING RESEARCH, CONFERENCE ON FAIRNESS, ACCOUNTABILITY, AND TRANSPARENCY 1-15 (2018) (present an approach to evaluate bias present in automated facial analysis algorithms and datasets).

[87] See, e.g., Robert Bartlett et al., Consumer-Lending Discrimination in the Era of FinTech (October 2018) (unpublished manuscript), https://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf (an empirical study comparing discrimination in lending by traditional mortgage origination firms with face-to-face interaction with borrowers and decisions made by fintech platforms; the study finds that "lenders charge Latinx/African-American borrowers 7.9 and 3.6 basis points more for purchase and refinance mortgages respectively, costing them $765M in aggregate per year in extra interest").

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

Cyberattacks capture national and international attention because of their pervasive effects. For example, in December 2013, Target, a national retailer, announced that it was the target of a massive data breach. The hackers who orchestrated the data breach obtained the confidential credit and debit card information of more than 40 million customers. As investigations ensued, Target continued to adjust its estimate of the number of records accessed, ultimately reporting that hackers captured the personal data of as many as 110 million customers. In 2014, hackers invaded home improvement retailer Home Depot's records and acquired 56 million customers' credit and debit account information and 53 million customers e-mail addresses.

Equifax's settlement this week illustrates the perils of cyberattacks against credit reporting agencies. Between mid-May 2017 and July 2017, Equifax, one of the country's largest CRAs suffered one of the largest known financial data breaches, exposing the personal information (names, addresses, dates of birth, Social Security numbers, and driver's license numbers) of more than 148 million Americans, 8,000 Canadians, and nearly 700,000 UK citizens.

Former Equifax CEO Richard Smith in testimony before Congress explained that the data breach resulted from hackers' exploitation of a flaw in "Apache Struts," an open source web application. While a patch was released during the first week of March 2017, Equifax failed to apply the security updates until two months later. Equifax should have addressed this vulnerability within forty-eight hours, but it did not.[88] Equifax's information security scans also failed not detect the Apache Struts vulnerability.[89]

On May 13, 2017, hackers exploited this vulnerability to access Equifax's systems and consumers' personally identifiable information.[90] Between May 13, 2017 and July 30, 2017, evidence suggests that the attackers continued to access sensitive information, exploiting the same Apache Struts vulnerability without being detected by Equifax's security tools.[91]

Mr. Smith notified the Equifax board about the breach on August 22, 2017.[92] On September 7, 2017, Equifax disclosed the breach to the American public.[93] In other words, Equifax waited six

---

[88] *Oversight of the Equifax Data Breach: 7 Answers for Consumers, Hearing Before the U.S. H. Comm. on Energy and Commerce Subcomm. on Digital Commerce and Consumer Protection*, 115th Cong. 3 (2017) (statement of Richard F. Smith, CEO, Equifax), https://democrats-energycommerce.house.gov/sites/democrats.energycommerce.house.gov/files/documents/Testimony-Smith-DCCP-Hrg-on-Oversight-of-the-Equifax-Data-Breach-Answers-for-Consumers-2017-10-03.pdf.
[89] *Id.*
[90] Stacy Cowley, *2.5 Million More People Potentially Exposed in Equifax Breach*, N.Y. TIMES (Oct. 2, 2017), https://www.nytimes.com/2017/10/02/business/equifax-breach.html.
[91] *Oversight of the Equifax Data Breach: 7 Answers for Consumers, Hearing Before the U.S. H. Comm. on Energy and Commerce Subcomm. on Digital Commerce and Consumer Protection*, 115th Cong. 3 (2017) (statement of Richard F. Smith, CEO, Equifax), https://democrats-energycommerce.house.gov/sites/democrats.energycommerce.house.gov/files/documents/Testimony-Smith-DCCP-Hrg-on-Oversight-of-the-Equifax-Data-Breach-Answers-for-Consumers-2017-10-03.pdf.
[92] *Id.*
[93] *Id.*

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

weeks from the time they discovered the breach until they disclosed said breach to the American public. The Equifax settlement marks one of the largest data breach settlements and will provide up to $425 million in consumer restitution. The settlement reflects a number of measures that Equifax will take to protect consumers' personal data and assist with fraud detection.

The Equifax data breach demonstrates the systemically important role of CRA in credit markets and US financial markets. As the universe of fintech firms expands, regulatory oversight of these entities must reflect the nature of the information that the firms will collect, store and transfer. Regulation must also reflect the significant role of the these firms in the stability of consumer credit markets and broader financial markets.

As the Office of the Comptroller of the Currency ("OCC") and Federal Deposit Incorporation's ("FDIC") consider paths for granting fintech firms special purpose nonbank charters and Industrial Loan Corporation ("ILC") charters concerns mount regarding careful monitoring of fintech firms' privacy and cybersecurity measures and their ability to protect the collection, storage and transfer of alternative data.

Blockchain-Based Credit Scoring and Lending Models

For several years, fintech firms and conventional CRAs have integrated learning algorithms into credit scoring models. In more recent years, developers began to advocate for credit scoring models built on decentralized, distributed digital ledger protocols.

On January 27, 2018, Jesse Leimgruber, Alain Meier, John Backus published a whitepaper for Bloom Protocol, a "credit staking" decentralized credit scoring platform powered by Ethereum and the Interplanetary File System. According to the whitepaper, Bloom plans to offer three main services: Bloom ID (Identity Attestation), BloomIQ (Credit Registry) and BloomScore (Credit Scoring). According to Bloom, its model addresses the shortcomings of traditional credit scoring by transitioning the credit scoring process to the blockchain protocol. Touting its success as one of the first distributed ledger credit scoring and lending platforms in the world, Bloom promises to facilitate cross border credit scoring, accommodate users with no credit history, secure personal information, increase global access to credit development and provide greater competition in the credit risk evaluation market.

Bloom introduces three unique models: the BloomID, BloomIQ and Bloom Score. Using a peer assessment methodology, Bloom claims that consumers with thin, limited, impaired or no credit history may demonstrate creditworthiness and enjoy access greater access to credit. While the whitepaper clearly indicates that the model will evaluate conventional criteria such as loan and bill repayment history, Bloom relies heavily on social networking to assess a consumer's eligibility to receive credit. A number of important details regarding Bloom's methodology are not revealed in the whitepaper, but there is significant potential for a decentralized distributed ledger based credit

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

scoring platform to assist invisible and unscorable consumers by offering greater transparency in the credit evaluation process, a more easily reviewable and correctible credit report and reduced incidents of fraud and data breaches.

For decades, consumer advocates, academics, regulators and state and federal legislators have recognized that low-income consumers pay remarkably more for basic financial services such as check cashing, money transfers and short-term loans. Nearly ten percent of American households continue to lack access to traditional savings and checking accounts.

Consumers with limited access to basic banking services, those living in financial services deserts (requiring them to commute significant distances to bank branches) have had too few options for obtaining access to credit on fair and reasonable terms. Check cashing storefronts, payday loan outlets and other predatory financial services providers exploited invisible or unscorable consumers' lack of access to conventional banking and credit services.[94]
Fintech firms operating at the intersection of startup innovation and consumer credit evaluations raise a number of the normative questions.[95] As artificial intelligence increasingly influences the terms and availability of credit, this nascent technology and the firms adopting it will come to perform an important gatekeeping function, determining whose receives access to credit, and for those with access, learning algorithms will likely decide the most fundamental terms of any credit arrangement.

To be sure, the advent of artificial intelligence technology disrupts legacy banking, inspires a new market infrastructure and spurs development that *may* benefit unbanked and underbanked consumers. The successful expansion of access to credit may depend largely on regulators' effective supervision of the integration of alternative data and reliance on opaque, inscrutable and non-intuitive algorithms.

State Chartered Cryptocurrency Exchanges

A central issue in the discussion above is *how* the government ought to use its authority to charter banks. In recent years, states legislatures have adopted regulation to expand the types of businesses eligible for state banking charters. In July of 2014, the State of New York announced the creation of the "BitLicense," to regulate persons or companies involved in virtual currency business activity. To date, New York has authorized roughly two dozen licenses.

In 2019, the State of Wyoming enacted laws enabling the chartering of special purpose depository institutions (SPDIs). SPDIs may "receive deposits and conduct other incidental activities,

[94] Twenty percent of families with traditional bank accounts still rely on alternative financial services outlets. Jason Furman, *Financial inclusion in the United States*, June 10, 2013 available at https://obamawhitehouse.archives.gov/blog/2016/06/10/financial-inclusion-united-states.

[95] E. Gerald Corrigan, *Are Banks Special?:* ANNUAL REPORT 1982, FEDERAL RESERVE BANK OF MINNEAPOLIS (raising fundamental questions regarding the role of banks and prudential regulation).

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

including fiduciary asset management, custody and related activities." An SPDI may operate in a manner similar to a custodian bank, offering services such as "storing assets, fiduciary management, conducting a variety of transactions with assets and providing an 'on/off' ramp to securities markets, commodities markets and customer bank accounts." In September 2020, Wyoming approved the SPDI application for Kraken Bank, a digital asset company based in Cheyenne, Wyoming.

Wyoming's approval of Kraken's SPDI application triggers concerns as the company's stated goal is to "establish a connection between cryptocurrency and the traditional financial system." Unlike traditional banks, Kraken deposits will not be insured by the FDIC. To address this issue, Wyoming regulators will require Kraken to maintain a reserve of 100 percent of deposits as fiat currency and "liquid assets."

While laudable, Wyoming's efforts may not be sufficient to address the enterprise and systemic risk management concerns that chartering cryptocurrency banks or exchanges create. Immediately following Wyoming's announcement, critics raised concerns. Cryptocurrency exchanges operating as banks present unique consumer protection and safety and soundness concerns.
Global financial markets are in the midst of a transformative movement that marks a watershed moment in the evolution of the financial markets ecosystem. Purportedly, peer-to-peer distributed digital ledger technology eliminates legacy financial market intermediaries such as investment banks, depository banks, exchanges, clearinghouses, and broker-dealers.

Yet careful examination reveals that cryptocurrency issuers and the firms that offer secondary market cryptocurrency trading services have not quite lived up to their promise. Notwithstanding crypto-enthusiasts' calls for disintermediation, evidence reveals that platforms that facilitate cryptocurrency trading frequently employ the long-adopted intermediation practices of their traditional counterparts. In fact, when emerging technologies fail, cryptocoin and token trading platforms partner with and rely on traditional financial services firms. As a result, these platforms face many of the risk-management threats that have plagued conventional financial institutions as well as a host of underexplored threats. Automated or algorithmic trading strategies, accelerated high frequency trading tactics, and sophisticated Ocean's Eleven-style cyberheists leave crypto-investors vulnerable to predatory practices.

Early responses to fraud, misconduct, and manipulation emphasize intervention when originators first distribute cryptocurrencies—the initial coin offerings. This testimony rejects the dominant regulatory narrative that prioritizes oversight of primary market transactions. Instead, I propose that regulators introduce formal registration obligations for cryptocurrency intermediaries – the exchange platforms that provide a marketplace for secondary market trading. This approach recognizes the dynamic nature of cryptocurrency secondary market actors seeking to achieve disintermediation yet balances the potential benefits of trading intermediaries with normative regulatory goals—protecting investors from fraud, theft, misconduct, and manipulation; enforcing

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

accountability; preserving market integrity; and addressing enterprise and systemic risk-management concerns.

Despite federal and state regulators' warnings and mounting civil and criminal enforcement actions, investors continue to flock to cryptocurrency markets, buying coins and tokens in initial coin offerings (ICOs).[96] At its high-water mark in 2021, exponential growth characterized the near $1 trillion cryptocurrency market.[97] As governments, private stakeholders, and academics cast a spotlight on ICOs, a shadow fell, obscuring nefarious activity on secondary trading market platforms.

Media reports chronicle the endemic challenges in cryptocurrency secondary markets. Bitfinex, one of the world's largest cryptocurrency exchanges, is a prominent example. Founded in 2012, Bitfinex has survived *Ocean's Eleven*-style heists that emptied hundreds of millions of dollars of customer assets from its coffers.[98] Periodic cyberattacks have temporarily paralyzed Bitfinex's platform, suspending trading and halting customer withdrawals.[99] Yet, these incidents are only the tip of the iceberg.

Bad actors swarm secondary market trading in cryptocurrency markets. Traditional banks are reticent to permit cryptocurrency exchanges to open accounts; thus, these platforms often rely on "shadow banks."[100] For example, Bitfnex initially routed customer transactions through a Taiwanese bank to Wells Fargo.[101] Then, on April 18, 2017, Wells Fargo began blocking Bitfinex

---

96.*See* Jake Frankenfield, *Initial Coin Offering (ICO)*, INVESTOPEDIA (Sept. 26, 2020), https://www.investopedia.com/terms/i/initial-coin-offering-ico.asp [https://perma.cc/VT78-LB7R] ("An Initial Coin Offering (ICO) is the cryptocurrency industry's equivalent to an Initial Public Offering (IPO).").

97.*Global Charts: Total Market Capitalization*, COINMARKETCAP, http://coinmarketcap.com/charts/ [https://perma.cc/NS33-QDQ7].

98.Nathaniel Popper, *Warning Signs About Another Giant Bitcoin Exchange*, N.Y. TIMES (Nov. 21, 2017), https://www.nytimes.com/ 2017/11/21/technology/bitcoin-bitfinex-tether.html [https://perma.cc/77A6-4GZ7].

99.Daniel Palmer, *Major Crypto Exchanges Bitfinex and OKEx Hit by Service Denial Attacks*, COINDESK (June 12, 2020, 3:27 PM), https://www.coindesk.com/major-crypto-exchanges-bitfinex-and-okex-hit-by-traffic-denial-attacks [https://perma.cc/42EN-2MLP]; Andrey Shevchenko, *Crypto Exchanges OKEx and Bitfinex Suffer Simultaneous DDoS Attacks*, COINTELEGRAPH (Feb. 28, 2020), https://cointelegraph.com/news/crypto-exchanges-okex-and-bitfinex-suffer-simultaneous-ddos-attacks [https://perma.cc/KS5P-T4FA]. For examples of earlier cyberattacks, see Steven Russolillo, *Hackers Swipe More Than $40 Million of Bitcoin from Cryptocurrency Exchange*, WALL ST. J. (May 8, 2019, 2:27 AM), https://www.wsj.com/articles/hackers-swipe-more-than-40-million-of-bitcoin-from-cryptocurrency-exchange-11557296830?mod=article_inline [https://perma.cc/H4RJ-7ZGD].

100.Paul Vigna, *Lack of Banking Options a Big Problem for Crypto Businesses*, WALL ST. J. (May 17, 2019, 12:34 PM), https://www.wsj.com/articles/lack-of-banking-options-a-big-problem-for-crypto-businesses-11558092600 [https://perma.cc/F7RD-NYN6].

101.*Id.*

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

wire transfers.[102] Bitfinex pivoted to a Puerto Rican bank—Noble Bank.[103] On October 1, 2018, Noble Bank lunged toward bankruptcy.[104] Bitfinex transferred $850 million to a Panamanian nonbank payment processing platform—Crypto Capital.[105] Another fleeting solution. Within a year, the Polish government arrested Crypto Capital's President Ivan Manuel Molina Lee for his role laundering money on behalf of an international drug cartel.[106] Bitfinex shocked the cryptoworld, announcing that the $850 million in customer funds held by Crypto Capital had vanished.[107]

Beyond Bitfinex's firm-specific risk-management concerns—the conflicts of interest, woefully deficient compliance controls, anemic consumer protection policies, and remarkably inadequate cybersecurity measures—the entire industry grapples with operational and systemic risks: fake bank accounts, mismanagement of customer funds, blatant theft, garden-variety fraud, and exploitative and abusive trading strategies.[108]

Stunningly, none of the three hundred trading platforms facilitating cryptocurrency secondary market transactions has obtained requisite approval from federal or state authorities to operate as an exchange.[109] Regulators have formally prosecuted only a handful of trading platforms.[110] Most

---

102.*See id.*

103.Ana Berman, *Bloomberg: Puerto Rico's Noble Bank Reportedly Loses Clients Tether, Bitfinex, Seeks Buyer*, COINTELEGRAPH (Oct. 2, 2018), https://cointelegraph.com/news/ bloomberg-puerto-ricos-noble-bank-reportedly-loses-clients-tether-bitfinex-seeks-buyer [https://perma.cc/D53Y-RUA9].

104.*Id.*

105.Paul Vigna, *Bitfinex Used Tether Reserves to Mask Missing $850 Million, Probe Says*, WALL ST. J. (Apr. 25, 2019, 11:21 PM), https://www.wsj.com/articles/bitfinex-used-tether-reserves-to-mask-missing-850-million-probe-finds-11556227031 [https://perma.cc/R4EW-4NDH]; *see also* Press Release, N.Y. Att'y Gen., Attorney General James Announces Court Order Against "Crypto" Currency Company Under Investigation for Fraud (Apr. 25, 2019), https://ag.ny.gov/press-release/2019/attorney-general-james-announces-court-order-against-crypto-currency-company [https://perma.cc/G4YV-63A6].

106.Samuel Haig, *Bitfinex Cries Fraud as Crypto Capital Executive Indicted by US*, COINTELEGRAPH (Oct. 30, 2019), https://cointelegraph.com/news/bitfinex-cries-fraud-as-crypto-capital-executive-indicted-by-us [https://perma.cc/M65Y-SVWE].

107.Steve Ehrlich, *After an $850 Million Controversy, What Everyone Should Know About Bitfinex, Tether and Stablecoins*, FORBES (May 2, 2019, 9:09 AM), https://www.forbes.com/sites/stevenehrlich/2019/05/02/after-an-850-million-controversy-what-everyone-should-know-about-bitfinex-tether-and-stablecoins/?sh=19d2f02e492f [https://perma.cc/4GTT-BH75].

108.David Floyd, *Fraudulent Trading Drove Bitcoin's $150-to-$1,000 Rise in 2013: Paper*, INVESTOPEDIA (June 25, 2019), https://www.investopedia.com/news/bots-drove-bitcoins-150to1000-rise-2013-paper/ [https://perma.cc/JQZ3-W3BB].

109.*See Today's Cryptocurrency Prices by Market Cap*, COINMARKETCAP, http://coinmarketcap.com/ [https://perma.cc/RU94-8KH3]; *see also* Nathan Reiff, *How Much of the World's Money is in Bitcoin?*, INVESTOPEDIA (June 21, 2020), https://www.investopedia.com/tech/how-much-worlds-money-bitcoin/ [https://perma.cc/DA2X-CL5R].

110.*See e.g.*, Press Release, U.S. Commodity Futures Trading Comm'n, CFTC Orders Bitcoin Exchange Bitfinex to Pay $75,000 for Offering Illegal Off-Exchange Financed Retail Commodity Transactions and Failing to Register as a

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

troubling, however, are the breadth and depth of these challenges among the small group of actors that has captured the greatest market share in global cryptocurrency secondary trading markets. Why have Congress and regulators failed to impose order in the Wild West of cryptocurrency secondary market trading?

Financial services regulation is complex and growing more complex each day.[111] Among other challenges, regulators do not always understand *what* exactly (transactions, other activities, or attributes) gives rise to regulatory intervention.[112] Complicated financial products precipitated the financial crisis that began in 2007,[113] and, in the wake of the crisis, many were disillusioned. Legacy financial institutions and other market participants' avaricious, self-serving, and predatory behavior initiated a polarized debate regarding the federal government's $700 billion bailout of Wall Street intermediaries.[114] Developers began to imagine a financial services industry without traditional intermediaries—depository banks, investment banks, stock exchanges, brokers, and dealers.

Innovative financial technology (fintech) products and firms aimed to disrupt conventional financial markets and displace legacy financial institutions.[115] Programmers introduced alternative financial products and platforms, namely peer-to-peer distributed digital ledger platforms that originate and distribute cryptocurrencies.[116]

Futures Commission Merchant (June 2, 2016), https://www.cftc.gov/PressRoom/ PressReleases/pr7380-16 [https://perma.cc/DCZ9-FUAS].

111.*See* Shaanan Cohney, David Hoffman, Jeremy Sklaroff & David Wishnick, *Coin-Operated Capitalism*, 119 COLUM. L. REV. 591, 603 (2019); *see also Examining Facebook's Proposed Cryptocurrency and Its Impact on Consumers, Investors, and the American Financial System: Hearing Before the H. Comm. on Fin. Servs.*, 116th Cong. (2019) (statement of Chris Brummer, Professor of Law, Georgetown University Law Center) [hereinafter Statement of Chris Brummer], https://financialservices.house.gov/uploadedfiles/hhrg-116-ba00-wstate-brummerc-20190717.pdf [https://perma.cc/T7EU-5NEJ] (describing the structure of Facebook's proposed Libra network); *id.* (statement of Katharina Pistor, Edwin B. Parker Professor of Comparative Law and Director, Center on Global Legal Transformation, Columbia Law School) [hereinafter Statement of Katharina Pistor], https://financialservices.house.gov/uploadedfiles/ hhrg-116-ba00=wstate-pistork-20190717.pdf [https://perma.cc/5LJG-CT2P].

112.*See* Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L.J. 235, 263-64 (2019).

113.*See, e.g.*, Saule T. Omarova, *The Quiet Metamorphosis: How Derivatives Changed the "Business of Banking,"* 63 U. MIAMI L. REV. 1041, 1041 (2009).

114.*See* David M. Herszenhorn, *Congress Approves $700 Billion Wall Street Bailout*, N.Y. TIMES (Oct. 3, 2008), https://www.nytimes.com/2008/10/03/businessworldbusiness/03iht-bailout.4.16679355.html [https://perma.cc/K6J8-TUHM].

115.Brummer & Yadav, *supra* note , at 263-64; Rory Van Loo, *Making Innovation More Competitive: The Case of Fintech*, 65 UCLA L. REV. 232, 232 (2018); William Magnuson, *Regulating Fintech*, 71 VAND. L. REV. 1167, 1167 (2018); Adam J. Levitin, *Pandora's Digital Box: The Promise and Perils of Digital Wallets*, 166 U. PA. L. REV. 305, 305-06 (2018); Jeanne L. Schroeder, *Bitcoin and the Uniform Commercial Code*, U. MIAMI BUS. L. REV. 1, 1 (2016); Angela Walch, *The Bitcoin Blockchain as Financial Market Infrastructure: A Consideration of Operational Risk*, 18 N.Y.U. J. LEGIS. & PUB. POL'Y 837, 837 (2015).

116.This Article refers to distributed digital technology protocols as "enterprises." A rich literature explores the development of entities operating in a manner that is colloquially described as partnerships, trusts, and other business

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

Since the publication of the Bitcoin blockchain White Paper in 2010, markets have witnessed the origination of more than five thousand cryptocurrencies.[117] In the ensuing decade, regulators have scrambled to keep pace. Distributed digital ledger technology and the popular subset of blockchain-based technologies are among the most innovative technologies in the financial markets ecosystem.[118] Central banks, national governments, and significant financial institutions increasingly signal an interest in the origination, distribution, and exchange of proprietary cryptocurrencies.[119] Indisputably, these coins and tokens have moved from the shadows to center stage.

---

organizational forms notwithstanding their failure to formally adopt (and in some cases they even reject) the notion that they operate pursuant to a conventional business structure; an even more interesting discussion emerges upon recognizing that these entities increasingly rely on algorithms to make fundamental operational and investment decisions. *See* Shawn Bayern, *Are Autonomous Entities Possible?*, 114 NW. U. L. REV. ONLINE 23, 24-25 (2019) (responding to criticism from Lynn Lopucki); *see also* Lynn M. Lopucki, *Algorithmic Entities*, 95 WASH. U. L. REV. 887, 887 (2018).

117. *Compare Historical Snapshot-01 January 2017*, COINMARKETCAP, http://coinmarketcap.com/historical/20170101/ [https://perma.cc/78XM-6FGQ] (listing 636 coins on the market in 2017), *with Historical Snapshot-06 January 2019*, COINMARKETCAP, http://coinmarketcap.com/historical/20190106/ [https://perma.cc/5GUS-3RAA] (listing slightly over two thousand coins on the market in 2019).

118. While many use the language "blockchain technology" and "digital ledger technology" (DLT) interchangeably, the two are not synonymous. Media accounts, popular accounts, and the literature conflate the general theory of DLT with blockchain applications and, perhaps even more disappointingly, use the terms interchangeably. For the purposes of this Article, I will aim to use DLT to describe the foundational technology, and blockchain to refer to specific protocols or applications. While DLT and blockchain are not synonymous, the distinctions are too technical to explore here and do not alter the analysis and conclusions presented in this Article.

For a useful introduction to DLT and an analysis of the epistemological challenges in the literature, see Carla L. Reyes, *If Rockefeller Were a Coder*, 87 GEO. WASH. L. REV. 373, 379-82 (2019) (describing DLT as "computer software that is distributed, runs on peer-to-peer networks, and offers a transparent, verifiable, tamper-resistant transaction-management system maintained through a consensus mechanism rather than by a trusted third-party intermediary that guarantees execution"); *see also* Angela Walch, *The Path of the Blockchain Lexicon (and the Law)*, 36 B.U. REV. BANKING & FIN. L. 713, 719-20 (2017) ("Blockchain technology, sometimes called 'the blockchain' or just 'blockchain,' is alternatively referred to as 'distributed ledger technology' (DLT), 'shared ledger technology' (SLT), 'consensus ledger' technology, 'mutual distributed ledger' technology, or even a decentralized or 'distributed database.'" (citations omitted)).

For an interesting comparative discussion, see Samantha Stein, *Hashgraph Wants to Give You the Benefits of Blockchain Without the Limitations*, TECHCRUNCH (Mar. 13, 2018, 11:00 PM), https://techcrunch.com/2018/03/13/hashgraph-wants-to-give-you-the-benefits-of-blockchain-without-the-limitations/ [https://perma.cc/5V6L-RDJQ]. While the bitcoin blockchain protocol is one of the most popular and well-known blockchain protocols, there are an increasing number of financial and nonfinancial blockchain protocols. Consider, for example, Ethereum (another exceedingly popular blockchain with diverse financial and nonfinancial applications), Hashgraph (a hashgraph algorithm), or an asynchronous Byzantine Fault Tolerance (aBFT) consensus mechanism based on a virtual voting algorithm combined with the gossip protocol or Directed Acyclic Graphs (DAGs). *Cf.* Press Release, Globe Newswire, tune.fm Launches New Token Protocol on Hedera Hashgraph (Aug. 5, 2020), https://apnews.com/press-release/globe-newswire/3601a20bf7c29098f1df2eb77dfee4f9 [https://perma.cc/XH8C-URZY].

119. Anna Isaac & Caitlin Ostroff, *Central Banks Warm to Issuing Digital Currencies*, WALL ST. J. (Jan. 23, 2020, 11:15 AM), https://www.wsj.com/articles/central-banks-warm-to-issuing-digital-currencies-11579796156

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

In my recent article, *Decentralized Finance: Regulating Cryptocurrency Exchanges*, I introduce the general attributes of cryptocurrencies and a propose the need to carefully evaluate the use of specific terminology by regulators and cryptocurrency market participants, specifically, the use of the terms "centralized" and "decentralized" as applied to cryptocurrencies and cryptocurrency exchanges. I argue that many of exchanges that self-identify as "decentralized" or disintermediated continue to rely on some aspect of "off-chain" or traditional intermediation.

Several exchanges market themselves to trading communities as decentralized distributed digital ledger platforms, however their use of the term "decentralized" varies from misnomer, to mistake, to an active misrepresentation of the operational infrastructure of the exchange. Regulators must refuse to elevate form over substance and investigate the central operational mechanics of the platforms and interrogate the cryptocurrency platforms' plans to minimize or eliminate attributes that centralize trading.

Unless genuinely "decentralized," cryptocurrency secondary market platforms face many of the same risks and concerns that conventional market participants struggle to address within their firms and across the industry. As the Bitfinex example illustrates, regulation (or the lack thereof) casts cryptocurrency trading markets into the shadows and invites variegated forms of manipulation and misconduct. The automation or integration of increasingly sophisticated algorithms in trading markets has altered the nature of secondary market trading, resulting in market conditions that may disadvantage less sophisticated trading counterparties. Coupled with automation, high frequency trading (HFT) strategies accelerate the pace of trading. HFT strategies may employ algorithms or bots or co-locate their server closer to an exchange to take advantage of the delay between a buyer or seller placing an order and the execution of the trade (latency). HFT strategies also often employ controversial trading tactics such as front-running, pinging, and spoofing.

Finally, my research suggests that another class of pernicious concerns challenges cryptocurrency secondary trading markets—cybersecurity threats. Evidence of the harms and losses that result from these enterprise risk-management failures should raise alarms. These risks will increase as cryptocurrency markets grow, and likely create spillover effects and systemic risks that impact other areas of financial markets.

[https://perma.cc/Y9EP-FS4D]; Nathaniel Popper, *Central Banks Consider Bitcoin's Technology, if Not Bitcoin*, N.Y. TIMES (Oct. 11, 2016), https://www.nytimes.com/2016/10/12/business/dealbook/central-banks-consider-bitcoins-technology-if-not-bitcoin.html [https://perma.cc/9E5J-Y6HF].

Emory University
Gambrell Hall
1301 Clifton Road
Atlanta, Georgia 30322-1013
An equal opportunity, affirmative action university

kristin.johnson@emory.edu
Tel 404.727.6816
Fax 404.727.6820

Testimony of

Carlos Pacheco
Chief Executive Officer
Premier Members Credit Union

On behalf of
The National Association of Federally-Insured Credit Unions

"Banking Innovation or Regulation Evasion?
Exploring Modern Trends in Financial Institution Charters"

Before the
House Financial Services Subcommittee on Consumer Protection and Financial Institutions

April 15, 2021

Introduction

Good morning, Chairman Perlmutter, Ranking Member Luetkemeyer, and Members of the Subcommittee. My name is Carlos Pacheco, and I am testifying today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU). I am the CEO of Premier Members Credit Union, headquartered in Boulder, Colorado. I have over 30 years of experience in the financial services industry at both banks and credit unions, including having served in my current CEO role for over 10 years. Thank you for holding this hearing today. We appreciate the opportunity to share our views on the trends in financial institution charters.

Premier Members Credit Union is a member-owned and relationship driven credit union that serves consumers and businesses in Colorado's Front Range. Premier Members has more than 77,000 members, $1.4 billion in assets, 15 retail branch locations and four locations in area high schools. Premier Members takes pride in giving back to the communities it serves, supporting a wide variety of activities and fundraising events for charitable organizations like United Way, Realities for Children of Boulder County, Impact on Education and many more.

Background on Credit Unions

Credit unions serve a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system serves as a way to promote thrift and make financial services available to all consumers, many of whom would otherwise have limited access to financial services. Every credit union is a cooperative institution organized "for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes" (12 § USC 1752(1)). Congress established credit unions as an alternative to banks and to meet a precise public need, and today credit unions provide financial services to over 124 million people. Since President Franklin D. Roosevelt signed the *Federal Credit Union Act* (FCUA) into law over 85 years ago, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

1. Credit unions remain totally committed to providing their members with efficient, low-cost, personal financial services; and,

2. Credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

The nation's approximately 5,000 federally-insured credit unions serve a different purpose and have a fundamentally different structure than traditional banks. Credit unions exist solely for providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions, united by a common bond, all credit union members have an equal say in the operation of their credit union—"one member, one vote"—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors, something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration, epitomizing the true volunteer spirit permeating the credit union community. Credit unions are also limited by their field of membership on who they can serve.

As member-owned and relationship driven cooperatives, credit unions have been on the frontlines working with their members during these times of economic uncertainty. Credit unions have voluntarily implemented programs to protect their members' financial health, including skipping payments without penalty, waiving fees, low or no-interest loans, loan modifications and no interest accruals. The relief provided by Congress thus far during the pandemic has been helpful for credit union members. Still, the impacts of the pandemic are not over, and credit unions remain committed to ensuring we have the necessary tools to continue to support our members – consumers and small businesses – through this crisis.

As the Committee examines the emergence of new types of charters, we also believe it is important to take necessary steps to enhance existing charters, such as those for credit unions, to ensure that they can continue to serve and meet the needs of consumers and small businesses in an ever-changing financial services environment. From a credit union standpoint, this includes enacting H.R. 1471, the *Access to Credit for Small Businesses Impacted by the COVID–19 Crisis Act of 2021*, to make it easier for credit unions to help small businesses in need. Another aspect of this effort includes modernizing outdated requirements and governance provisions in the *Federal*

Credit Union Act, such as (1) expanding available investment options for credit unions to better serve their communities; and (2) allowing all types of credit unions to add underserved areas to their fields of membership in order to help increase financial services access to those in underserved populations. This also includes right-size regulation and examinations that do not overburden credit unions, especially while emerging competitors, such as fintech banks, could take advantage of flexibility from other regulators, or gaps in the regulatory system, that allow them to see less regulation and supervision than traditional institutions.

Fintech Presents Opportunities and Challenges

The growth of fintech in recent years offers new opportunities for the delivery of financial services. The use of financial technology can have a positive effect on credit union members. Credit unions have worked with fintech companies to improve efficiency in traditional banking, and many of the technologies that are commonplace today, such as credit cards and e-sign, would have likely qualified as "Fintech" when they were first introduced. Consumers today come to expect technological developments from their financial institution – from online banking to mobile bill pay. Many credit unions embrace innovations in technology in order to improve relationships with their members. While functional regulators such as the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) have been aggressive in pursuing chartering options in the fintech space, the National Credit Union Administration (NCUA) has traditionally taken a more conservative role in allowing new fintech opportunities for credit unions. Somehow a happy medium must be found.

The rapid growth of fintech can also present new threats and challenges. New entities are emerging in an environment that can be under-regulated. As such, NAFCU believes that Congress and regulators must ensure that when technology firms and fintechs compete with regulated financial institutions, they do so on a level playing field where smart regulations, oversight and consumer protections apply to all actors in that space. While many fintechs are still subject to various consumer protection and other laws, many are not subject to the examination authority of a federal regulator examining for safety and soundness, or subject to the same supervisory expectations as other players in the financial services marketplace. This creates cracks in the regulatory system that could pose risks to both the consumer and the financial system.

For example, fintech companies that specialize in lending, payments, or data aggregation present unique consumer protection concerns. A fintech company that permits consumers to consolidate control over multiple accounts on a single platform can elevate the risk of fraud and may not be subject to regular cybersecurity examination or comply with the same data privacy and protection expectations expressed by federal banking agencies who have interpreted the safeguard requirements of the *Gramm-Leach-Bliley Act* (GLBA). Some of these technologies serve essentially as "pass-through" entities that handle depository account information, but do not maintain the accounts. If they are compromised in a data breach, it is that consumer end point data from the depository account at a financial institution that may suffer the loss. The burden of the breach can then fall on the financial institution that holds the account, both to handle the loss and deal with the consumer. This poses a level of reputational risk for the financial institution. We have found that credit union members trust their credit union to help them when problems arise, and they turn to us because of our strong focus on member service – something many other entities do not have.

Although non-bank lenders are subject to consumer protection rules, the simultaneous connectivity and disaggregation of discrete services into monoline business models within the fintech marketplace can create supervisory challenges. The benefit of an examination-driven supervisory framework is that regulators will be able to detect and prevent harm to consumers before it occurs. The FTC's recent settlement with the operator of a mobile banking app that failed to provide its customers with timely access to funds illustrates the disadvantages of relying solely on the enforcement jurisdiction of the FTC to remedy the failures of under-regulated fintech companies.[1]

Additionally, consumers may not be aware that funds deposited with certain fintech companies are not insured the same way deposits at a credit union or bank are and could be subject to loss. This could cause consumer confusion, or even harm confidence in the financial system should one of

[1] FTC, Mobile Banking App Settles FTC Allegations that It Misled Users about Access to Funds and Interest Rates (March 29, 2021).

these companies experience a massive data breach or other fraud that causes a loss of consumer funds. One example of a step Congress could take to help ensure a level playing field is to require companies to provide consumers with a clear, concise and prominent disclosure if funds are uninsured.

NAFCU has outlined some of the challenges and opportunities in this area in more detail in a whitepaper that we released in late 2019.

Technology Companies Pursuing Financial Charters

As this hearing is examining today, we have seen a recent trend in which fintech companies are enjoying unprecedented liberalization of bank chartering rules to either acquire or become banks. Recent developments including both the OCC's new chartering options and the FDIC's chartering and approval of deposit insurance for a new wave of Industrial Loan Companies (ILCs) also present problems. In each case, a nonbank company can potentially evade regulation under the *Bank Holding Company Act* (BHCA), either because of a statutory loophole unique to ILCs, or because the entity seeking a limited purpose charter will not accept deposits. Lack of BHCA coverage raises serious concerns regarding the quality and extent of supervision for these specialized banking entities. Chartering additional ILCs or granting new licenses to nonbank payments companies could also weaken the safety and soundness of the wider financial system.

In certain cases, specialized, limited purpose bank charters may allow a fintech to operate with national bank privileges but without the same prudential safeguards that apply to traditional banks and credit unions. While some may characterize these chartering options as innovative, they can ultimately become loopholes which invite unnecessary risk into the financial system and create an uneven playing field.

Industrial Loan Companies

An ILC charter can offer certain nonbank parent companies the opportunity to skirt registration as a bank holding company and avoid consolidated supervision by the Federal Reserve.[2] This reduced

[2] Cocheo, Steve, "Fintech Charters Signal a Tectonic Realignment in Banking," July 22, 2020.

oversight is further exacerbated by the fact that the FDIC lacks a complete range of statutory authority to fully supervise certain parent companies of ILCs.[3] As a result, the relationship between a nonbank parent and its ILC subsidiary lacks the degree of transparency and accountability intended by the BHCA while at the same time inviting potentially hazardous comingling of banking and commercial activities. In other words, the ILC charter frustrates a core principle of prudential regulation: that a bank's parent company should serve as a transparent source of strength rather than an opaque source of risk. Although the FDIC has attempted to patch up some of this risk with new regulation, the agency's December 2020 rule for ILC parent companies is not a substitute for BHCA supervision, and the new rule drew a dissenting vote from one FDIC Board Member who characterized the watered-down restrictions on ILC parent influence as essentially weak.[4]

NAFCU believes that the FDIC approving new ILC deposit insurance applications at this time of economic uncertainty could weaken the stability of the financial system, and we have urged the FDIC to suspend further chartering activity for at least three years so that a fully informed analysis of supervisory risks can be conducted. Furthermore, given technology companies' interest in acquiring banks, the FDIC should also take heed of the unique privacy risks that might exist should consumer financial records find their way into the hands of nonbank parent companies or their subsidiaries through affiliate data sharing arrangements. A moratorium would also give Congress appropriate time to consider whether the ILC charter sufficiently maintains the separation between banking and commerce and is conducive to advancing the goals of financial inclusion given the nonbank parent's limited accountability to its banking subsidiary.[5]

---

[3] Under Section 10(b)(4) of the FDI Act, the FDIC is permitted to examine any insured depository institution, including an ILC, to examine the affairs of any affiliate, including the parent holding company, "as may be necessary to disclose fully (i) the relationship between the institution and the affiliate; and (ii) to determine the effect of such relationship on the depository institution." 12 U.S.C. § 1820(b)(4). However, this limited grant of authority is no substitute for the full range of examination powers necessary for consolidated supervision.

[4] Statement by FDIC Board Member Martin J. Gruenberg on the Final Rule: Parent Companies of Industrial Banks and Industrial Loan Companies at the FDIC Board Meeting (December 15, 2020).

[5] In contrast to BHCA banks, a non-BHC parent company would not be prohibited from commencing "new activities" if a subsidiary depository institution has a CRA rating that falls below satisfactory. See 12 CFR § 225.84.

The FDIC should be focused on helping ordinary consumers instead of devoting analytical and legal resources towards advancing the financial ambitions of technology giants.[6] To that end, we support a moratorium on the chartering of new ILCs, eliminating the BHCA loophole for current ILCs, and solidifying a core principle of banking regulation: that a bank's parent company should serve as a transparent source of strength rather than an opaque source of risk.

Special Purpose Fintech Charter

The emergence of new, fintech-powered business models has accelerated the disaggregation of bank services. This has not only increased competitive pressure but also challenged depository-centric models of financial supervision. The diversity of fintech companies and their role in the broader financial sector may necessitate reconsideration of existing models of regulation in the long run; however, an immediate focus for regulators and Congress must be to ensure that fintech companies are operating on a level playing field relative to traditional financial institutions, including credit unions. NAFCU has defined this focus in terms of compliance with federal consumer financial law, but adequate supervision is an equally important consideration.

Research suggests that fintech mortgage lenders may enjoy structural advantages as nonbanks; in essence, benefiting from reduced regulatory burden which corresponds with relaxed federal safety and soundness standards. One report presented at the FDIC's April 2019 Fintech Symposium posited that 60 to 70 percent of "shadow bank" (i.e., nonbank lender) growth is likely due to differences in regulation, and the rest due to advances in technology.[7] Other fintech companies may be enjoying reduced supervisory oversight even if they are subject to federal consumer financial law.

NAFCU recognizes that innovation depends on a fair, but flexible, regulatory regime for financial technology. Many credit unions partner with fintech companies to improve member service and historically these partnerships have proven invaluable to the growth and competitiveness of our industry. Accordingly, NAFCU has advocated for expanding opportunities for credit unions to

---

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

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

access pilot programs or regulatory sandboxes to test new products or services. At the same time, we have cautioned that frameworks designed to encourage innovation must not favor certain market participants at the expense of others.

When the OCC first introduced its general plan for a special purpose charter for fintech companies, NAFCU recommended that the OCC retain the core features of a national bank charter; namely, capital and liquidity requirements. Our position then assumed what we believe now, which is that the recipient of a specialized charter must be supervised as if it were *bank*, even if its particular business model places greater emphasis on services other than deposit-taking or lending. In this regard, NAFCU remains skeptical of the OCC's assertion that it can offer a charter to a nonbank licensee which confers the benefits of national preemption and other privileges that have traditionally supported banks' deposit taking and lending roles.

In order to maintain safety and soundness within the broader financial sector, Congress should ensure that a fintech charter recipient is supervised as if it were bank, regardless of whether its particular business model places greater emphasis on services other than deposit-taking or lending. Congress should also clarify that any special purpose fintech charter that confers the benefits of national preemption or other privileges that have traditionally supported banks' deposit taking and lending roles, is bound by the same capital, liquidity, and consumer protection rules applicable to traditional banks and credit unions.

Payments Charter

In 2020, the OCC bypassed normal notice and comment rulemaking procedures to invite payments companies to apply for a limited purpose "payments charter." The payments charter has since drawn significant criticism from banks and credit unions alike and has inspired new litigation based on its core premise: that an entity choosing not to accept deposits can obtain the same privileges as a national bank.

One significant risk associated with the payments charter is the potential for reduced supervision of the bank applicant's holding company. By not accepting deposits, a payments charter recipient might not be regarded as BHCA bank, and its parent could avoid consolidated federal supervision by the Federal Reserve. Depending on the scale or risk of the holding company's activities—which might involve facilitating cryptocurrency transactions or issuing stablecoins per recent OCC guidance—lack of comprehensive Federal Reserve oversight could create additional risks for the American taxpayer if a specialized charter recipient fails because of weaknesses deriving from its parent's activities.

Furthermore, the potential for a payments charter recipient to apply for master account access at the Federal Reserve could inject novel risk into our nation's payments systems. A payments charter recipient that does not accept deposits will not be clearly bound to the capital and liquidity standards normally applicable to banks that receive federal deposit insurance. Easing these important standards for entities that might access Federal Reserve clearing and settlement systems could profoundly impact the stability of our nation's financial infrastructure.

National Trust Banks

In 2020, the OCC issued new interpretations of its rules for national trust charters, without soliciting public input through notice and comment rulemaking. In essence, the OCC has paved the way for trust banks to engage in novel fiduciary activities such as cryptocurrency custodial services. In conjunction with its recent guidance on cryptocurrency custody services, the OCC has also taken the position that a permissible fiduciary activity for a national trust bank is any activity that state law permits for a state trust company which comes into competition with a national bank.

Previously, the OCC had taken the more prudent approach of first examining whether the proposed fiduciary activity was in fact 'fiduciary' within the meaning of 12 U.S.C. § 92a. The practical consequence of this new interpretation is to relax standards for conversions of state trust companies into non-depository, national trust banks. The OCC has now received applications from state trust companies that are heavily engaged in cryptocurrency-related activities. While there may be a role for this, we believe Congress should not allow the OCC to promulgate new chartering standards for trust banks through legal interpretations that bypass normal notice and comment rulemaking processes.

Crypto Charters

As regulators begin to review offering cryptocurrency charters, we believe it is important that any actions go through a formal notice and comment rulemaking process to help ensure that all perspectives are heard and reviewed.

What Can Be Done

NAFCU believes that there are a number of steps that should be taken to address our concerns. First, it is important that existing charters, such as the credit union charter, keep pace with advances in technology and consumer preferences to ensure that credit unions have the tools to serve their members' needs, especially post-pandemic. Additionally, as noted above, we support a moratorium on new ILC charters and closing the BHCA ILC loophole and are pleased to see those addressed in the *Bank Charter Review Act* and the *Close the ILC Loophole Act*. Congress should also ensure that the data security and privacy requirements for financial institutions in the GLBA, including supervision for compliance, apply to all who are handling consumer financial information and that programs for implementing these requirements conform to the guidance developed by Federal Financial Institutions Examination Council (FFIEC)member agencies.

NAFCU also believes financial regulators have a role to play in the supervision and regulation of fintechs under their existing authorities. Congress should also be willing to step in and clarify the role of regulators when necessary. For example, NAFCU believes that the Consumer Financial Protection Bureau (CFPB) can play a role under its "larger participants" authority under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* to regulate and supervise technology firms and fintech companies that enter into the financial services marketplace. If the CFPB does not believe it has this authority currently, Congress should examine granting the Bureau explicit authority in this area.

Congress should also consider creating a FFIEC subcommittee on emerging technology (the subcommittee) to monitor the risks posed by fintech companies and develop a joint approach for facilitating innovation.

We would envision the subcommittee having the following under its charge:

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

Conclusion

In conclusion, credit unions look forward to continuing to experience growth in the technology space as a way to better serve our members. We encourage the NCUA and other functional regulators to find a proper balance in this space. As technology companies expand, and new charters emerge to compete in the financial services marketplace, it is important that they compete on a level playing field of regulation and supervision – from data privacy and security to consumer protection. Finally, it is important that Congress ensures laws are modernized to allow regulated financial institutions, such as credit unions, to keep up and compete with technological advances.

I thank you for the opportunity to appear before you today and I welcome any questions that you may have.

Statement for the Record

on behalf of the

American Bankers Association

Before the

Subcommittee on Consumer Protection and Financial Institutions

April 15, 2021

Statement for the Record

on behalf of the

American Bankers Association

Before the

Subcommittee on Consumer Protection and Financial Institutions

April 15, 2021

The American Bankers Association[1] appreciates the opportunity to submit a statement for the record for the hearing titled "Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters." Recent activity at federal and state levels regarding granting novel charters should be subject to Congressional oversight to ensure the safety of consumers and the payment system itself.

As the only banking trade association representing banks of all sizes, ABA strongly supports and seeks to streamline de novo bank formation; supports and seeks to facilitate responsible bank innovation including new technologies, partnerships and business models; and believes in charter choice. We believe that our diverse banking ecosystem is a source of strength, and support new entrants and new ways of reaching consumers. However, we do not believe that jurisdictions should create new charters, or apply new interpretations to traditional charters, that are designed to pair bank-like benefits such as federal preemption and access to critical shared infrastructure like the Federal Reserve payment system, with less regulation and oversight of consumer and systemic risks.

New state charters focused on cryptocurrency business models and recent action at the OCC where applications for traditional charters are being considered and granted for non-traditional business models present novel risks to the payments system that we all rely upon to operate seamlessly. These new charters enable these entities to seek a bank charter without being subject to the same oversight and regulation as any other bank. This regulatory arbitrage risks creating a two-tiered system where these entities' customers and counterparties will be subject to increased risk and weaker consumer protections.

The state of Wyoming has created a Special Purpose Depository Institution (SPDI) bank charter that allows entities to hold uninsured customer funds. These SPDIs may be called banks, but they will not be subject to consolidated supervision, under the Bank Holding Company Act (BHCA), will not have FDIC oversight, and may create new opportunities for fraud or money laundering. Further, as they take only uninsured deposits or no deposits at all, these SPDIs and

[1] The ABA is the voice of the nation's $18.7 trillion banking industry, which is comprised of small, midsized, regional and large financial institutions. Together, these institutions employ more than 2 million people, safeguard $14.6 trillion in deposits and extend more than $10.5 trillion in loans.

non-traditional OCC chartered banks will not be subject to the Community Reinvestment Act (CRA). SPDIs grant entities bank powers without the accompanying oversight.

In recent months, the OCC has embarked on its own mission to broaden the definition of entities eligible to apply for standard charters. While the payments charter debate, and the OCC's special purpose chartering authority more broadly, is pending legal action, this new approach would allow entities that previously would not have met OCC requirements for a charter to be considered and in some cases granted a charter. The two recently granted OCC trust charters to firms offering digital custody services were made possible by OCC Interpretive Letter 1176[2] (IL 1176) issued during the last week of the former Acting Comptroller's tenure and two days before the charter applications were provisionally approved. IL 1176, drafted without any public comment or input, lowered the standard for eligibility for the OCC trust charter by denoting that any entity that meets a lower state charter requirement now, by default, is eligible for an OCC charter. The OCC also considered an application for a standard charter from an entity that would hold uninsured deposits.

- The novel charters and novel application of traditional charters at the state level and the OCC have a common theme. By avoiding the requirements regarding taking insured deposits, both the state and the federal charter "innovations" allow the parties to avoid regulation as a "bank" for the purposes of the BHCA. The BHCA should be required and not optional for these applicants. We believe that specific steps should be taken to ensure that attempts to achieve regulatory arbitrage in Wyoming and at the OCC do not present increased risks to consumers and the payment system. The Federal Reserve should develop evaluation procedures that will be consistent across all of its districts to evaluate the risk these novel charters and novel businesses with traditional charters will pose to the payment system. This policy should be developed in an open and transparent manner with public comment to ensure that all parties involved are able to participate. Access to the Federal Reserve payment system is a privilege and not a right
- Congress and the OCC should conduct a thorough review of OCC activities related to the publication of IL 1176 including the timing of its release and the decision to bypass the standard practice of a formal notice and comment period. Additionally, the OCC should provide its justification for considering granting entities holding uninsured deposits national bank charters.
- The OCC and states should not grant charters to banks that take deposits but are structured to avoid BHCA oversight.

[2] OCC Interpretative Letter 1176, January 11, 2021, https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1176.pdf

Special Purpose Depository Institutions (SPDIs)
In 2019, Wyoming created a new type of bank charter targeting cryptocurrency businesses. The entities recently chartered in Wyoming, Kraken Financial and Avanti Bank & Trust, are cryptocurrency-focused firms that have obtained state charters for the express purpose of, among other things, connecting directly to the payment system. We believe that the nature of the businesses engaged in by these entities presents heightened risks that should be taken into consideration before the Federal Reserve grants such access.

Kraken Financial's business model is unusual for state-chartered institutions and for depository institutions generally in that (1) its principal business is to provide a banking gateway between digital assets and national currencies (a business that raises heightened anti-money laundering, Bank Secrecy Act and terrorist financing concerns and is subject to high volatility[3]); and (2) it presents potential risk to the payment system and other risks without appropriate supervision across the breadth of its affiliated entities.

Avanti Bank and Trust plans to offer digital asset custody services and to act as a "bridge" to the U.S. payment systems. As part of its business model, it will create and issue Avit, a tokenized equivalent of the U.S. dollar to enable institutions to settle transactions in real time.

Under Wyoming's SPDI Charter, any deposits at these institutions must be 100 percent backed by reserves. Neither of these institutions will be required to have FDIC insurance or be subject to FDIC oversight. State law also prohibits SPDIs from making loans funded by customer deposits.

The lack of FDIC insurance and commercial loan offerings suggests that SPDIs would not meet the definition of a "bank" under the Bank Holding Company Act (BHCA). This means that related entities would not be subject to consolidated supervision by the Federal Reserve. This is a significant concern because, for example, Kraken Financial's parent company operates a large cryptocurrency exchange with an associated risk level that is unknown.

Another issue that is concerning is the lack of insight into how these entities will be examined. The Wyoming Banking Commission is the sole oversight body and it granted the charters before the examination guidelines were complete. It is troubling that a charter was issued without evidencing publicly an ability to evaluate the applicants' ability to meet requirements that had yet to be created.

Importantly, interest in these SPDI charters is growing within Wyoming and beyond, and the Federal Reserve is likely to face questions about access in multiple Districts. Specifically, proponents of the Wyoming approach are pressing for similar models in several states which could help facilitate adoption across the country. If they follow Wyoming's model there will be no federal oversight of these novel state charters.

Our banking system is enriched by new entrants, new technology, and new business models, but its strength and resiliency are derived from the assurance that every financial institution adheres to common regulatory standards and supervisory scrutiny. Applications for master accounts and

[3] Report of the Attorney General's Cyber Digital Task Force Cryptocurrency Enforcement Framework, October 1, 2020, https://www.justice.gov/ag/page/file/1326061/download

direct access to the payment system from state-chartered SPDIs novel and heightened risks that merit thoughtful consideration. More information is needed from these and future applicants to enable the Federal Reserve Banks to evaluate the risks of their direct access to the payment system.

We urge the Federal Reserve Board to delay granting non-traditional entities like these access to master accounts or Reserve Bank payments services until it has adopted, in a transparent manner after notice and comment, a uniform policy that would apply to the Federal Reserve Banks exercise of discretion when evaluating requests by non-traditional charter applicants for access to such services.

The OCC's Policy Shift Enabled by Interpretative Letter 1176

The OCC made significant policy changes regarding the eligibility requirements to receive a trust charter through IL 1176 without public input during the final days of the previous administration. That change has already, and will continue to facilitate, charter approvals that we believe are ill considered. We oppose the circumstances under which these applications are being submitted, evaluated, and even conditionally approved.

It seems that this process began in the summer of 2020 when Former Acting Comptroller Brooks made clear his belief that payments companies that neither take deposits nor make loans are eligible for a national bank charter. Shortly thereafter, a number of firms, particularly cryptocurrency-related firms, began applying for national bank and trust charters. The charter related activity concluded with a frenzy of activity during the final days of Comptroller Brooks' days at the OCC. The following timeline illustrates the activities.

On Friday, January 8th, 2021, a group of trade associations outlined concerns to the OCC in a comment letter on two pending applications for an OCC trust charter. The letter noted that the applicants' business models do not involve the types of fiduciary activities performed by national trust charter banks. In short, the Associations believe that providing custodial services for digital assets is not a fiduciary activity and that granting charters where traditional fiduciary activity is absent would represent a significant change in OCC policy that should be made only with proper public notice and comment period.

On Monday, January 11th, 2021, the OCC published Interpretive Letter 1176, OCC Chief Counsel's Interpretation on National Trust Banks that expanded the scope of entities eligible to apply for a national trust charter. The new interpretation effectively eliminated the longstanding requirement that applicants for national bank trust charters engage in fiduciary activities. This significant change in OCC policy was made with no public comment and review.

On Wednesday, January 13th, 2021, the OCC granted conditional approval to Anchorage Digital Bank (Anchorage) on the basis that its activities, primarily providing custodial services for digital assets, meets the requirements to receive a South Dakota state trust charter and under the new Interpretive Letter 1176, is eligible for a national trust charter.

A second state trust charter conversion to an OCC trust charter was granted on February 4th to Protego Trust Bank (Protego) based in Washington state. In its press release, Protego stated its core business lines are custody of digital assets, a digital asset trading platform for client use, facilitating digital asset lending and borrowing amongst bank clients, and issuing new digital assets. Because this was a conversion to an OCC charter there was no public comment period and information regarding its business model is limited. Like Anchorage, it appears Protego would not have been eligible for an OCC trust charter without Interpretive Letter 1176.

On Thursday, January 14, 2021, Acting Comptroller Brooks resigned.

On Wednesday January 20, 2021, all Executive Agencies received the Memo calling for a review of all pending rules and regulatory interpretations. The Interpretive Letter, as an "agency statement of general applicability and future effect that sets forth a policy on a statutory, regulatory, or technical issue or an interpretation of a statutory or regulatory issue" is precisely the type of agency action that the memo was intended to address. In the spirit of the memo's intent, we asked that Interpretive Letter 1176 be withdrawn and that any changes in the OCC's eligibility requirements for a national trust or national bank charter be subject to a conventional rulemaking process, with public notice and comment. This significant policy change deserves thorough and transparent analysis by all interested stakeholders.

The OCC responded that it is an independent agency and not bound by the Memo.

As noted earlier, we believe that IL 1176 should be recalled and the entire issue should be subject to a typical public notice and comment period. This is a significant policy change that is due an open and transparent review by the OCC and the public that it affects. Instead of a flurry of activity behind closed doors during the closing week of an administration this issue deserves deliberate considerations.

The OCC's Consideration of the Figure Bank National Bank Charter Application
We also believe that Congress and the public would benefit from learning more about the OCC's review of a recent application for a traditional charter by Figure Bank, a non-traditional entity. Although we support the OCC's many initiatives to facilitate financial innovation, the OCC must ensure that appropriate regulations apply consistently to all national bank charters and that no regulatory gaps emerge. In the case of Figure Bank, that threshold has not been met.

This is an application for a traditional OCC national bank charter by an entity that will not take insured deposits. Figure Bank would have a significantly different risk profile from a traditional bank and would also be subject to a very different set of regulations, given that many banking laws are triggered by insured deposit taking. This new bank would not be subject to FDIC oversight through the Federal Deposit Insurance Act (FDIA) or consolidated supervision by the Federal Reserve under the BHCA). Importantly, it will also not have any obligations under the Community Reinvestment Act (CRA). This non-traditional application for a traditional national bank charter is like inserting a square peg into a rectangular hole. It may fit if enough force is used, but that is not the way bank charters should be granted.

There is also significant uncertainty about the OCC's authority to issue charters to institutions such as these. Recently, the OCC proposed the creation of a special purpose bank charter to serve non-depository. That effort is currently being litigated in the Second Circuit. The New York Division of Financial Services (NYDFS) successfully challenged the OCC's authority to issue non-depository special purpose charters, and that case is currently under appeal.

<u>The OCC must work carefully and cooperatively with the other banking agencies before any non-traditional bank charter is approved to prevent regulatory arbitrage that could undermine the safety and soundness of the national banking system as a whole.</u>

For example, the Figure Bank application suggests that it will not be subject to consolidated supervision under the BHCA. Under the BHCA definition, a bank must either (i) have FDIC insurance or (ii) both accept demand deposits and make commercial loans. Although Figure Bank is applying for a national bank charter, its application actually resembles a special purpose bank charter application in that it would not take insured deposits and, therefore, would not have FDIC insurance or meet the definition of a bank under the BHCA. While limited purpose charters in the past have a specific exemption from "bank" status under the BHCA including trust charters and credit card banks, no such specific exemption exists for this standard national bank charter under consideration by the OCC, and the Federal Reserve Board has not yet publicized its views on the potential application of the BHCA to such a charter.

Through its authority under the BHCA, the Federal Reserve Board serves an important role in supervising banking organizations on a consolidated basis (i.e., banks together with their owners and affiliates). Importantly, the BHCA reflects Congress's policy determinations regarding oversight and supervision of holding companies that engage in activities beyond the bank subsidiary. Any change to this balance would represent a significant policy change. We believe that such a significant policy change should be subject to scrutiny through a robust, open, and transparent process in accordance with the Administrative Procedure Act public notice and comment process.

More information is needed regarding the Figure Pay product noted in the application. Figure Bank's application states that it will not take insured deposits, but it will offer "Figure Pay Deposit Accounts" to consumers. These accounts will accept ACH transactions and be linked to debit cards. The application provides no explanation on how Figure Pay will connect to the payment system. If it is through a financial institution, that institution should be identified.

<u>A non-depository national bank charter raises significant consumer protection concerns and may create reputational risk for all banks.</u>

Conclusion

The OCC should proceed with great care in its consideration of non-traditional applicants for national bank charters to ensure that it does not undermine the value of traditional charters by holding new applicants to less stringent standards.

A bank charter is a clear signal to customers that they are dealing with a trusted partner. The title "bank" carries significant weight in the mind of customers. Any company granted a national bank charter will receive the instant credibility that comes with being a bank. Likewise, any missteps by a company operating through a national bank charter will inevitably reflect on all banks. This is why a patient and careful process is required that ensures all key issues are fully addressed.

The OCC must exercise its powers carefully and be certain that all applicants for national bank charters meet and are held to the highest standards to protect consumers and the industry itself.

A bank charter is not something to be taken lightly. The seal of approval conferred by the OCC when it charters a national bank is an important marker of trust to customers. Based on the different level regulatory oversight that will be applied to Figure Bank because it does not take deposits than would apply to banks holding the same charter, we oppose the OCC granting a national bank charter to this applicant.

Thank you for the opportunity to submit this Statement for the Record.

AFSA
AMERICAN FINANCIAL SERVICES ASSOCIATION

April 14, 2021

The Honorable Ed Perlmutter
Chairman
Subcommittee on Consumer Protection and Financial Institutions
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Blaine Luetkemeyer
Ranking Member
Subcommittee on Consumer Protection and Financial Institutions
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Perlmutter and Ranking Member Luetkemeyer:

On behalf of the American Financial Services Association (AFSA), I am writing today in advance of your hearing, *"Banking Innovation or Regulation Evasion? Exploring Modern Trends in Financial Institution Charters."*

Founded in 1916, AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. In 1971, AFSA merged with the American Industrial Bankers Association, an organization of industrial banks, thrift and loan companies, and sales financial companies, and we are proud to continue represent those banks.

Industrial banks are subject to the same banking laws and are regulated in the same manner as other depository institutions. They are supervised and examined both by the states that charter them and by the Federal Deposit Insurance Corporation (FDIC). They are subject to the same safety and soundness, consumer protection, deposit insurance, Community Reinvestment Act, and other requirements as other FDIC-insured depository institutions,

Most parent companies of industrial banks are exempt from Federal Reserve Board supervision as bank holding companies. Instead, the FDIC and the relevant state banking department provide the equivalent supervision, including requiring additional capital and liquidity support. Additionally, unlike most bank holding companies, the carefully vetted non-financial parent companies have the independent financial strength to serve as a source of strength to their banks.

Similar Bank Holding Company Act exemptions apply to thousands of institutions not owned by other companies and to financial institutions that do not offer a full range of banking services, such as credit card banks, Edge Act banks, grandfathered non-bank banks, and trust banks. These exemptions benefit bank customers by introducing additional competition into the marketplace, without increased risk to the deposit insurance system.

Industrial banks, which have existed since 1910, evolved from Morris Plan Banks, consumer lending institutions organized at a time when commercial banks generally did not make consumer loans or offer deposit accounts to individuals.[1] The word "industrial" in their names stems from the original mission of providing credit to industrial workers, not to the industries themselves. Industrial banks engage in consumer and commercial lending on both a secured and unsecured basis. They may accept savings accounts, including Money Market Deposit Accounts, time deposits, and deposits that may be withdrawn through negotiable orders of withdrawal ("NOW") accounts.

During the past five decades, industrial banks have compiled among the best records of capitalization and profitability of any group of banks in the nation, and they represent a sector of the financial services industry that should be encouraged to grow.

Though not required to be regulated as federal bank holding companies, owners of industrial banks are not "unregulated." Indeed, they are subject to many of the same requirements as bank holding companies, such as strict restrictions on transactions with their bank affiliates. Furthermore, industrial banks are regulated under state law, they are subject to examination by the FDIC, and to "prompt corrective action" and capital guarantee requirements if the banks they control encounter financial difficulties.

Should you need additional information or have any questions, please feel free to contact me at cwinslow@afsamailorg or (202) 776-7300. Thank you very much for the opportunity to comment.

Sincerely,

Celia Winslow

Celia Winslow
Senior Vice President
American Financial Services Association

[1] Predating the Federal Reserve System by three years and FDIC by twenty-three years.

BANK POLICY INSTITUTE

Submitted Statement for the Record of Greg Baer,

President and CEO, Bank Policy Institute

House Committee on Financial Services

Subcommittee on Consumer Protection and Financial Institutions Hearing:

"Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters"

April 15, 2021

The Bank Policy Institute is a nonpartisan public policy, research and advocacy group, representing the nation's leading banks and their customers. Our members include universal banks, regional banks and the major foreign banks doing business in the United States. Collectively, they employ almost two million Americans, make nearly half of the nation's small business loans, and are an engine for financial innovation and economic growth.

Banks operating in the U.S. are restricted in their risk-taking and activities in order to ensure their safety and soundness, compliance with consumer protection laws, and financial system stability. Those restrictions include capital and liquidity requirements, resolution requirements, and an extraordinarily intensive examination regime that oversees every aspect of their operations, often by multiple regulators. Banks practice financial innovation within this highly regulated framework.

Banks historically have also been prohibited in engaging in non-financial activities in what is known as the separation of banking and commerce. Bank holding companies may engage only in activities that are financial in nature or incidental or complementary to such activities – a list of activities that has not been meaningfully expanded over the past twenty years.

In recent years, nonbank technology firms — FinTechs and Big Techs — have begun offering banking products and services without being subject to most rules applicable to banking organizations, and generally without any onsite examination to determine compliance with what regulations do apply. They have exploited gaps in regulation to avoid both the general prohibition on mixing banking and commerce and the regulatory and examination regime that comes with offering banking products.

Regulatory arbitrage generally takes one of two routes. First, because most federal banking regulation is tied to the offering of federally insured deposits, many commercial companies have sought state or newly imagined federal charters that give them all banking powers other than the power to offer such deposits – without most of the legal obligations (and some important rights) that traditionally and appropriately come with being a bank. Second, through state industrial loan company charters, they have received almost full banking powers.

The Bank Policy Institute has published a significant amount of research documenting problems with the ersatz state charters and reimagined OCC charters, but the focus of this statement is the industrial loan company charter.[1]

Background on ILCs

ILCs were first established in the early 1900s to make small loans to industrial workers. Until 1987, most ILCs were small, locally owned institutions that had only limited deposit-taking and lending powers under state law. At the end of 1987, the largest ILC had assets of only approximately $410 million, and the average asset size of all ILCs was less than $45 million. The relevant states also were not actively chartering new ILCs; Utah (the state traditionally most invested in the ILC charter) had only 11 state-chartered ILCs, and had a moratorium on the chartering of new ILCs. Moreover, interstate banking restrictions and technological limitations made it difficult for institutions chartered in a grandfathered state to operate a retail banking business regionally or nationally.

The ILC industry changed dramatically in 1987 with adoption of the Competitive Equality in Banking Act (CEBA), which required an ILC to either engage only in activities in which it engaged as of March 5, 1987 or be chartered in a state that required ILCs to be FDIC-insured as of March 5, 1987 and to meet certain criteria in order to be eligible for the exemption.[2] In 1997, Utah lifted its moratorium on the chartering of new ILCs, allowed ILCs to call themselves banks and authorized ILCs to exercise virtually all of the powers of state-chartered commercial banks.[3] Since that time, Utah also has begun to charter new ILCs and to promote the ILC charter as a method for companies to acquire an insured depository institution while avoiding the requirements of consolidated federal examination and regulation under the Bank Holding Company Act.[4] For example, unlike a regulated bank holding company or intermediate holding company of a foreign bank, the corporate owners of an ILC are ***not*** subject to:

- The consolidated capital requirements established by the Federal Reserve;
- The consolidated liquidity standards established by the Federal Reserve;
- The financial holding company standards established by Congress in the Gramm-Leach-Bliley Act (GLB Act), which generally require a company to be well capitalized and well managed, and its insured depository institution subsidiaries maintain at least a "Satisfactory" rating under the Community Reinvestment Act (CRA), to engage in the wider range of financial activities authorized by the GLB Act; or

---

[1] *See* BPI's Resource Site, "Keep Banking Safe" available at www.KeepBankingSafe.com.
[2] Where permitted by state law, an ILC may offer demand deposits if the ILCs assets are less than $100 million or if the ILC has not been acquired after Aug. 10, 1987. ILCs with less than $100 million in assets and those acquired prior to Aug. 10, 1987 are exempt from this restriction. ILCs are permitted to offer negotiable order of withdrawal accounts, which are functionally very similar to demand deposits.
[3] Under Utah law, ILCs are generally authorized to make consumer and commercial loans and to accept federally insured deposits, but not demand deposits if they have total assets greater than $100 million.
[4] https://dfi.utah.gov/financial-institutions/industrial-banks/.

- Regular examination by a Federal banking agency to ensure the company complies with the Interagency Guidelines Establishing Information Security Standards (see 12 C.F.R. Part 225, App. F).

Indeed, even if an ILC was to grow to have assets of more than $250 billion, the corporate parent would avoid the enhanced capital, liquidity and other prudential standards (such as stress testing) that Congress required in the Dodd-Frank Wall Street Reform and Consumer Protection Act for the largest U.S. banking organizations.

In addition, changes in both federal law and technology now allow an FDIC-insured ILC chartered in a grandfathered state to open branches and offer its products to consumers and businesses throughout the country.

The Need for Congressional Action

Policymakers should close the regulatory gap opened by the ILC charter before it is fully exploited by the nation's largest companies in a way its drafters never imagined. It seems clear from the historical context that the ILC exemption was not intended to provide a loophole enabling ownership of federally insured banks by commercial firms, since Congress was intent on strengthening the policy of separating banking and commerce. In particular, Sen. Jake Garn (R-UT), the original sponsor of the ILC exemption in CEBA, stated during a public hearing on the Walmart ILC application that "it was never my intent, as author of this particular section, that any of these industrial banks be involved in commercial operations."

ILCs introduce unique risks to the banking system and the Deposit Insurance Fund because their parent companies are exempt from the BHCA and thus can avoid the same consolidated federal supervision and regulation framework or activity restrictions as bank holding companies, even though ILCs offer banking products and services that are functionally indistinguishable from those offered by commercial banks.

Furthermore, Big Tech ownership of ILCs presents an additional set of concerns about the protection of consumer data, including sensitive personal financial information. This is a critical consideration due to the gaps created when ILC parent companies are not subject to the same information security and financial privacy requirements as parent companies of commercial banks. An ILC parent company would have limited restrictions on the use of consumer financial data for commercial purposes, a concern heightened by Big Tech's ownership of ILCs due to the possibility of discriminatory pricing and provision of banking services based on this data. The absence of enterprise-wide privacy and information security requirements thus creates risk for ILC customers.

Congress Should Act Now to Protect the Integrity of the Financial System and Consumers

BPI supports Congress closing the ILC loophole while recognizing the fact that parents of ILCs that are subject to consolidated supervision by the Federal Reserve do not pose additional risks to the system and need not be included in any eventual limitation on ILC parent companies. These include both bank holding companies and foreign banking organizations with operations in the United States that are already regulated as bank holding companies under the International Banking Act. BPI also supports grandfathering existing ILCs as of March 2020.

While the FDIC recently attempted to codify more effective regulation, Congress has long since determined that the Federal Reserve is the appropriate regulator of companies that own banks, and that oversight of those companies should include capital and liquidity requirements and, for larger companies, enhanced prudential standards. The FDIC's rules, which are enforced by agreement with the agency, are no substitute. In addition, the FDIC retains the discretion to eliminate or reduce any requirements imposed by those agreements.

Moreover, Congress should act to maintain the historical separation of banking and commerce in U.S. law. Past (and potentially, future) efforts by large commercial firms, such as Walmart and Home Depot, to acquire FDIC-insured ILCs have raised significant concern, and the FDIC's proposal would not prevent such firms, or large technology companies such as Facebook or Amazon, from acquiring FDIC-insured ILCs. Indeed, Rakuten, which is widely known as the "Amazon of Japan," currently has an application pending with the FDIC to establish an FDIC-insured ILC.

BPI's members welcome competition with new entrants to the banking system provided that those new entrants are subject to the same prudential supervision framework and activity restrictions that Congress has established for the corporate owners of full-service insured banks. And consumers should not be subject to increased risk solely because their bank is chartered as an ILC in the handful of states that have the ability to charter ILCs. BPI urges Congress to act soon to ensure that the financial system and America's consumers are protected from heightened risks posed by the advance of large technology firms into the banking system while avoiding the framework established for the corporate owners of full-service insured banks. The time to close the ILC loophole is now, before it further undermines the principles that form the bedrock of banking supervision and regulation in the United States.

April 14, 2021

The Honorable Ed Perlmutter, Chair
U.S. House Subcommittee on Consumer Protection
and Financial Institutions
2129 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Blaine Luetkemeyer, Ranking Member
U.S. House Subcommittee on Consumer Protection
and Financial Institutions
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chair Perlmutter and Ranking Member Luetkemeyer:

On behalf of the Consumer Bankers Association (CBA), I write to share our views on special purpose charters, specifically regarding parent companies of industrial banks and industrial loan companies (ILCs) in advance of the House Subcommittee on Consumer Protection & Financial Institutions hearing entitled "Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters."

The future of the financial institution charters, specifically ILC charters, are of particular interest to CBA because our association was formed in 1919 as the Morris Plan Bankers Association for the purpose of promoting America's first industrial banks, then known as Morris Plan Banks.[1] Today, CBA is the only national trade association focused exclusively on retail banking; our 69 member banks employ nearly 2 million Americans, extend roughly $3 trillion in consumer loans, and hold assets totaling $14.5 trillion or 79% of all bank holding company, bank and thrift assets in the United States. While the vast majority of our current members are not ILCs, CBA remains committed to the need and purpose of consumer banking that inspired the nation's first industrials.

Advancements in the financial marketplace have allowed the ILC charter to evolve from its simple beginnings of providing small loans to industrial workers. Our members are especially concerned the rise in non-financial commercial companies seeking ownership of ILCs may facilitate perilous growth of shadow banking and threaten the Deposit Insurance Fund (the DIF) and the safety and soundness of the traditional banking system. In their recently enacted rule regarding ILCs (the rule), the FDIC has implemented welcome strategies and safeguards for overseeing commercial companies.[2] This rule is a welcome development but should not in practice become an inadequate substitute for the consolidated supervision that applies to and is required of banks and their holding companies.

Although ILCs commonly support specialty finance operations for parent companies engaged in activities that have a strong nexus to finance, ILCs may also be leveraged by the largest commercial or retail enterprises (including global mega-conglomerates) to avoid the laws governing well-regulated banks and their holding companies. We believe that as the primary regulator the FDIC should ensure commercial companies cannot use the ILC charter as a conduit into the banking system and federal safety net while engaging in activities that have always been off limits for regulated banks and their holding companies.

---

[1] In 1934 the Morris Plan Bankers Association was renamed the Industrial Bankers Association. Since 1946, the Association has operated under its current name, the Consumer Bankers Association.

[2] Parent Companies of Industrial Banks and Industrial Loan Companies, 12 C.F.R. § 354 (2020).

1225 New York Avenue, NW, Suite 1100, Washington, DC 20005
consumerbankers.com

CBA | CONSUMER BANKERS ASSOCIATION

Unlike banks and their holding companies, ILCs and their parent companies are not subject to Federal consolidated supervision or the Bank Holding Company Act's (BHCA) prohibition against mixing banking and commerce. This regulatory structure may incentivize commercial companies to choose the ILC charter to avoid heightened regulatory restrictions associated with the bank charter.[3] If commercial parents are permitted to use ILC charters to engage in excessive risk-taking without adequate oversight from the agency, the FDIC and the DIF will ultimately pay the price for downside risk that flows back to ILCs. **CBA believes the ILC charter and choice-of-charter plays an important role in facilitating a competitive financial system, however, the federal safety net should not be used to subsidize commercial parent companies unless these entities are subject to the same rigorous scrutiny as bank holding companies within the regulated financial system.** Although Congress authorized the current framework, the FDIC is right to issue rules leveling the playing field and imposing safeguards on the ILC charter to provide supervisory parity with the bank charter. In this regard, CBA believes FDIC's rule is a step in the right direction and we applaud the FDIC for formalizing and strengthening its existing processes for supervising ILCs to mitigate risk to the DIF in the absence of consolidated supervision.

Thank you again for your decisive actions and leadership on these topics and we look forward to working with you to ensure the best possible outcome for consumers and lenders.

Sincerely,

Richard Hunt
President and CEO

Cc: Members of the Subcommittee

[3] In a 2012 Report to Congressional Committees, the U.S. Government Accountability Office confirmed these advantages and entities preference for the ILC charter when it determined "commercial holding companies would most likely divest themselves of their exempt institutions [i.e. their ILCs] if the BHCA exemptions were removed." GAO-12-160 at page 33 (Jan. 2012).

1225 New York Avenue, NW, Suite 1100, Washington, DC 20005
consumerbankers.com

The Honorable Ed Perlmutter
Chairman
Subcommittee on Consumer Protection
and Financial Institutions
Committee on Financial Services
United States House of Representatives

The Honorable Blaine Luetkmeyer
Ranking Member
Subcommittee on Consumer Protection
and Financial Institutions
Committee on Financial Services
United States House of Representatives

April 19, 2021

Dear Chairman Perlmutter and Ranking Member Luetkemeyer:

The Financial Technology Association (FTA) appreciates the opportunity to submit this letter for the record of the Subcommittee on Consumer Protection and Financial Institutions hearing on "Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters."

We welcome the Subcommittee's exploration of financial institution charters and believe strongly in the importance of crafting forward-leaning policy frameworks that safeguard consumers and facilitate consumer-centric innovation and competition. We further believe that federal and state banking regulators have sufficient authority, expertise, and tools to appropriately apply statutorily authorized bank charters in order to expand the availability of inclusive, low cost, and innovative financial services, while mitigating identifiable risks.

The Financial Technology Association.

The Financial Technology Association (FTA) is a nonprofit trade organization that educates consumers, regulators, policymakers, and industry stakeholders on the value of technology-centered financial services and advocates for the modernization of financial regulation to support inclusion and innovation.[1] The FTA is focused on proactively shaping tomorrow's regulations, policy frameworks, and public understanding in order to safeguard consumers and advance the development of trusted, digital financial markets and services.

Technology-driven innovation is transforming the way we offer, access, and benefit from financial services and markets in the United States. By using internet and mobile platforms, machine learning, automation, and other modern technologies to deliver financial products and

[1] Financial Technology Association, *Shaping the Future of Finance* (Mar. 2021).

services, fintech companies are improving efficiency and transparency, broadening equity, access and inclusion, reducing costs, and increasing choice and opportunities for consumers and small businesses.

These advances are coming at a critical time for the American economy. Millions remain underbanked or underserved, income and wealth inequality continues to grow, and businesses seek to rebuild from the devastation caused by the COVID-19 pandemic. Fintech can provide individuals and SMBs with access to key financial services as they seek to restart, rebuild, or re-energize their financial lives and businesses.

In Pursuit of Modern Regulatory Frameworks that Safeguard Consumers and Promote Innovation and Competition.

The FTA supports the application of statutorily authorized banking charters to consumer-centric fintech firms, which would accordingly be subject to heightened regulatory oversight, including with respect to privacy under the Gramm-Leach-Bliley Act (GLBA) and fair lending under the Equal Credit Opportunity Act (ECOA).

The FTA believes that federal and state banking regulators have sufficient knowledge, expertise, and tools to appropriately establish and apply requirements that can safely expand the availability of inclusive, low cost, and innovative financial services, while mitigating risks. Indeed, regulation should protect consumers through proportionate and tailored requirements that solve for identifiable risks.

To this end, the FDIC recently exercised its authority to clarify regulatory requirements around industrial loan corporations (ILCs), and in the process reinforced its capacity to soundly regulate such institutions. Additionally, in its most recent approvals of two ILC applications, the FDIC underscored its focus on safety and soundness by imposing capital and other requirements that exceed those typically imposed on traditional *de novo* banks and ensured pursuant to Dodd Frank that the parent company of the ILC will serve as a "source of financial strength" for the ILC.[2]

Banking regulators have long held authority and had the capacity to accommodate the inevitable evolution of the business of banking. For example, such is the case with the OCC recognizing and chartering credit card banks -- once a novel and innovative concept -- and other special

[2] Cleary Gottlieb, "FDIC Approves Two New ILCs and Proposes Supervision of ILC Parents," Alert Memorandum (Mar. 26, 2020).

purpose national banks.[3] Limiting regulators' existing authority will stifle innovation and ensure a financial services landscape unable to accommodate consumer demand, innovation, and competition.

The Centrality of Consumer Protection.

It is important to note that a failure to create viable regulatory paths for fintechs creates greater risks by potentially excluding fintech innovation from bank oversight frameworks. By instead recognizing the benefits of new models and permitting direct chartering and bank partnerships, regulators can bring fintech firms into the regulatory fold and ensure more holistic oversight -- in other words, the opposite of a deregulatory effort.

It is further important to underscore that FTA recognizes the substantial privilege afforded to firms permitted to participate in the banking system in return for heightened oversight. A chartering path should not be available to those firms engaged in predatory behavior or that build business models predicated on the failure or poor outcomes of customers. Modernization of financial regulatory frameworks does not mean relaxing important consumer safeguards, but rather anchoring requirements to a clear analysis of the benefits provided by new forms of delivering needed financial services and a clear understanding of risks that require mitigation.

Conclusion: Building A Better Future of Finance.

It is within the context of seeking to shape a more fair, equitable, and empowering financial system that FTA supports viable chartering and licensure paths for new entrants offering safe and consumer-centric services, and opposes efforts to arbitrarily limit chartering authority provided to financial regulators. Consumers and small businesses in America deserve access to services provided by firms that are seeking to advance financial choice, access, and opportunity and that are voluntarily seeking enhanced federal and state banking oversight.

We look forward to serving as a resource to the Subcommittee as it continues its important work, and would welcome the opportunity to provide additional information.

Sincerely,

The Financial Technology Association

[3] OCC, "Exploring Special Purpose National Bank Charters for Fintech Companies," December 2016.

ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA®

April 15, 2021

Preserving the Integrity of the Bank Charter: The Community Bank Perspective

The Independent Community Bankers of America, representing community banks across the nation with more than 50,000 locations, appreciates the opportunity to provide this statement for the record for today's hearing, "Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters." We appreciate the Committee raising the profile of fundamental questions that will determine the future of the American financial services landscape. We are pleased to share the community bank perspective on these critical questions.

Congress Must Assert its Authority Over the Fundamental Legal Framework of Banking

This is a time of transformative change in the financial services marketplace. Community banks welcome responsible innovation and recognize that technological change underscores the importance of a robust legal framework to ensure consumer protection as well as the safety and soundness of our institutions and of the financial system as a whole. In addition, we must not allow technological change to simply erode the long-standing U.S. policy of separating banking and commerce embodied in the Bank Holding Company Act, a policy created in the 1930s in response to concerns about concentration of economic power. Mixing banking and commerce inevitably creates market distortions and leads to cross-sector consolidation. In the age of big data, social media and e-commerce conglomerates, this threat is greater now than it was in the 1930s.

Because the legal framework of banking is fundamental and the stakes are far reaching and significant, any changes to the financial structure should be debated and deliberated in Congress, not merely through oversight but through the legislative process. Only Congress has the requisite authority as well as the power to ensure consistent regulation and oversight across charters issued by different agencies. Agencies should not infringe upon congressional authority by, for example, creating new charters and conferring new financial powers on non-depository institutions that have traditionally and with sound reason been limited. As we argue below, the Office of the Comptroller of the Currency's (OCC's) proposed fintech charter and payments charters are examples of "charter slippage" that carry harmful, unintended consequences. In addition, the industrial loan company (ILC), though not a new charter, has historically been limited and is offered by only a handful of states. A state chartered ILC has the power to operate nationwide. Prior to 2020, the FDIC had not approved deposit insurance for a new ILC for more than 10 years. As discussed below, we urge Congress to reexamine the significant risks posed by the ILC charter.

Policy Must Promote Innovation

Innovation in financial services is critical to a modern, and increasingly digital, economy. Significant financial innovation is occurring today within traditionally chartered institutions and in partnership with cutting edge technology companies. Innovation offers financial consumers the choices they have come to expect and the speed and ease of transactions that today's technology makes possible. Such innovation is also the key to the United States' international competitiveness. But we must not envision a false tradeoff between financial innovation and fundamental consumer and systemic protections. Public policy can encourage responsible innovation by creating more flexible regulation for depository institutions and ensuring a commensurate regulatory regime and oversight for entities pursuing bank charters.

Limited Purpose Charters: General Skepticism is Warranted

ICBA urges Congress to take a skeptical view of the creation of new limited purpose charters. In view of the evolution of other limited purpose bank charters—such as the ILC which is discussed more fully below—ICBA is concerned that any limited purpose fintech bank charter could end up having all of the advantages and benefits of a full-service bank charter without commensurate supervision and regulation. What begins as a narrow charter crafted to serve a particular demographic or a niche form of banking has the potential to grow and reshape the financial services landscape. Again, this potential calls for the intervention of Congress.

OCC Fintech Charter Would Distort Financial Marketplace

In 2018, the OCC indicated that it was open to accepting applications for national bank charters from non-depository fintech companies engaged in the "business of banking." While such a charter would subject online lenders and fintech companies to more oversight and regulation than they now have—particularly in the area of consumer protection—these companies would be subject only to limited safety and soundness supervision and examination and would not be subject to the Community Reinvestment Act (CRA).

A special-purpose national bank charter for fintech firms would create an unlevel regulatory playing field. By evading the fundamental precepts of bank regulation in the United States, applicants for these charters would also gain a substantial and unfair advantage over other national and state banks that operate, consistent with Federal law, as insured banks. The OCC has contemplated the possibility of a narrow purpose bank charter applicant that would not take deposits and therefore would not have FDIC insurance or meet the definition of bank. The precedent-shattering approach of granting a national bank charter to an institution that accepts only uninsured deposits would violate the Federal law, the consistently expressed intent of Congress, and public policy considerations essential to the functioning of the nation's financial system. Conversely, approving a national bank charter for such an institution would provide a new pathway to evade the comprehensive regulatory regime established by Congress for banks and their holding companies.

ICBA supports the development of a fintech regulatory framework that is no less stringent than that which applies to insured depository institutions and their parent companies. Notably, Congress must exercise its power to sets any new charter regime variants. The OCC should publish transparent capital and liquidity requirements for these firms that specifically address minimum levels considered appropriate for a fintech firm to be well capitalized. Fintech capital and liquidity requirements should be no less rigorous than those that apply to insured depository institutions. Such a framework would promote a fair regulatory system, protect consumers, and support safety and soundness at these companies.

ICBA strongly supports a District Court ruling that the National Bank Act "business of banking" clause only allows the OCC to issue charters to depository institutions. The OCC is appealing that decision to the 2nd Circuit Court of Appeals. ICBA has filed an amicus brief in support of the New York Department of Financial Services.

OCC Payments Charter Could Compromise the Federal Reserve Payments System

In 2020, former Acting Comptroller Brian Brooks announced his intent to launch a special purpose payments charter, which could be used by non-depository companies to access the Federal Reserve payments system and safety net.

The special-purpose payments charter raises many of the same concerns raised by the fintech charter. It could be used to access the Federal Reserve payment system and avoid state consumer protection laws. In addition, such a charter, which could be owned by commercial companies, would violate the long-standing principle of the separation of banking and commerce. Would the non-bank parent company of a new special purpose payments bank be subject to the Bank Holding Company Act (BHCA)? If not, the parent company would not be subject to consolidated supervision, capital and liquidity requirements, and would not be required to act as a source of strength to its subsidiary payments bank. For these reasons, the special purpose payments charter would create more risk in the Federal Reserve payments system.

Because the National Bank Act does not authorize such a charter, any changes to it should first be debated and deliberated in Congress. Without explicit authority from Congress, OCC should not proceed with the issuance of these charters.

SPDI Charters Present Novel and Heightened Risk to the Payments System

Special purpose depository institution (SPDI) charters created under state law for non-traditional financial institutions such as cryptocurrency and blockchain companies also present novel and heightened risk to the payments system. Enabling these companies to receive deposits and conduct a range of other traditional banking activities without requiring them to obtain FDIC insurance could potentially harm consumers who may believe they are afforded the same protections as a national bank. As additional states embrace cryptocurrency as a "business development gold rush" and consider legislation that would create SPDI charters for cryptocurrency companies, ICBA is concerned about potential asymmetries that would encourage risk of regulatory arbitrage. The benefits of innovation must not come at the expense of the integrity of the banking and payments systems, they must be accomplished in a manner that addresses the unique risks that these new business models may present.

The Federal Reserve Board should direct the Reserve Banks not to grant non-traditional entities access to accounts or payments services until it has adopted uniform policy governing their exercise of discretion in granting such access.

INDEPENDENT COMMUNITY BANKERS *of* AMERICA®

This policy, which should be developed in a transparent manner including notice and comment, should apply to requests submitted by SPDIs created under state law or through other means. Nontraditional companies seeking a federal or state charter should be subject to the same regulatory framework that applies to insured depository institutions.

Industrial Loan Companies

The ILC loophole allows commercial companies to own financial institutions that are the functional equivalent of banks and effectively mix banking and commerce.

The Dodd-Frank Act included a three-year moratorium on FDIC approval of deposit insurance for new ILCs. However, in the past year, the FDIC approved the applications of Square and Nelnet. There are currently six applications pending before the agency, including applications from Rakuten and GM Financial, each of which should raise concerns about the mixing of banking and commerce, impartial allocation of credit, consumer privacy and risk to the taxpayer. We can expect more massive technology and social media companies to seek to exploit the ILC loophole. If this exploitation is allowed, it would shift the American financial landscape and give rise to a whole new dimension of risk, a threat not only to our prosperity and economic diversity but to consumer privacy and fraud on a massive scale. What's more, commercial owners of ILCs, unlike bank holding companies, are not subject to consolidated supervision by the Federal Reserve. This constitutes a dangerous gap in financial safety and soundness oversight and new risk to the FDIC insurance fund.

ICBA strongly supports the "Close the ILC Loophole Act," sponsored by Rep. Jesús "Chuy" García, which would amend the Bank Holding Company Act to remove the exemption for ILCs from the definition of a bank with a one-year transition period, thereby permanently closing the ILC loophole.

ICBA would also support a temporary moratorium on ILC applications so that Congress can consider permanent closure of the loophole. The "Bank Charter Review Act," would create a three-year moratorium on the approval of deposit insurance applications for new ILCs and require and General Accountability Office to carry out a study of various federal and state banking charters. As you know, the Dodd-Frank Act created a three-year moratorium.

Closing

Thank you again for convening today's hearing. The questions before the committee are fundamental to the future direction of American financial services and should be exclusively within the purview of Congress not the agencies. We urge you to assert your authority over these important questions and offer to work with you to develop and advance appropriate legislation.

National Association of Industrial Bankers | NEVADA BANKERS ASSOCIATION — INVESTING IN NEVADA TOGETHER | UTAH BANKERS ASSOCIATION

The Honorable Ed Perlmutter
Chairman
Subcommittee on Consumer Protection
and Financial Institutions
Committee on Financial Services
United States House of Representatives

The Honorable Blaine Luetkemeyer
Ranking Member
Subcommittee on Consumer Protection
and Financial Institutions
Committee on Financial Services
United States House of Representatives

April 14, 2021

Dear Chairman Perlmutter and Ranking Member Luetkemeyer:

The National Association of Industrial Bankers[1], the Utah Bankers Association[2] and the Nevada Bankers Association[3] appreciate the opportunity to submit this statement for the record of the Subcommittee on Consumer Protection and Financial Institutions hearing on "Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters."

I. Introduction

We applaud the efforts of the Subcommittee to investigate the changing dynamics of financial services in America. It is important that Congress ensure that American businesses and families have access to basic financial services, but with robust consumer protections.

The Subcommittee is also to be commended for focusing on key issues regarding financial stability, risks, benefits, and market fairness in analyzing financial institution charters. These are important elements in protecting consumers while enhancing the strength of the American economy.

The discussion in the hearing is likely to include comments regarding Industrial Loan Corporations. Since these institutions became eligible for FDIC insurance in the 1980s, knowledgeable practitioners prefer the term "industrial banks" (IB) as a more accurate description of these entities.

[1] First chartered in 1910, industrial banks operate under a number of titles – industrial banks, industrial loan banks, industrial loan corporations and thrift and loan companies. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the U.S. economy. NAIB members are chartered in California, Nevada and Utah.

[2] The Utah Bankers Association is the professional and trade association for Utah's commercial banks, savings banks and industrial banks. Established in 1908, the UBA serves, represents and advocates the interests of its members, enhancing their ability to be preeminent providers of financial services.

[3] Nevada Bankers Association is the united voice of Nevada's diverse banking industry: our members are dedicated to providing the best financial products, services and resources to drive and support economic growth, job creation and prosperity throughout the state of Nevada.

National Association of Industrial Bankers
60 South 600 East
Suite 150, Salt Lake City, UT 84102
(801) 355-2821 | industrialbankers.org

Nevada Bankers Association
1001, E Sunset Rd #96513
Las Vegas, NV 89193
(702) 233-8607 | Nvbankers.org

Utah Bankers Association
175 South Main Street, Suite 1420,
Salt Lake City, UT 84111
(801) 364-4303 | utah.bank

As you explore the opportunities and risks associated with innovation in the financial services sector, please note the following facts verified by decades of historical performance:

- **Industrial banks are the safest and soundest insured depository institutions in the country.**
- **Industrial banks are fully regulated like every other bank by federal and state regulators.**
- **Industrial banks have never posed a systemic risk to the nation's economy.**

We welcome the Subcommittee's exploration of the details of the industrial bank charter because members will discover that the industrial bank charter provides the perfect environment to facilitate innovation while protecting consumers and taxpayers against risk. We recognize that some voices will always resist new entrants and the competition they create, but new entrants and the innovation they bring benefit consumers, especially those who are currently underserved. We know this is an especially important priority for this Congress.

Congress and the federal banking agencies have thoroughly explored the operations and regulatory model of industrial banks. The last fifteen years have seen two moratoria and several studies, each of which has reached the conclusion your Subcommittee is likely to reach. Nevertheless, the forces aligned against new entrants continue to make the same arguments and call for delay, another moratorium, and more study.

We ask the Subcommittee to note that the information we provide is based upon quantitative sources such as FDIC call reports, premier academic analyses, and judgments of state regulators. We also recommend "A New Look at the Contribution and Performance of Industrial Loan Companies to the US Banking System" by James R. Barth and Yanfei Sun, Department of Finance, Auburn University, July 2017[4].

II. Historical background

A century ago, a new financial industry was created with the purpose of providing loans to low- and moderate-income industrial workers who had stable jobs but little access to bank credit. Because these institutions had industrial workers as their primary customers, they have been known ever since as industrial loan companies or "industrial banks" (IB).

Throughout their existence, IBs have always been state-chartered or -licensed institutions that make loans and offer their customers deposits, investment certificates, or both. During the Great Depression, when banks were failing in large numbers, IBs became the leading providers of consumer credit to workers. (IBs reprised this role as an important source of credit during the recent financial crisis.)

IBs have evolved to become a modern financial industry offering a wide range of products and services to a diverse group of customers.

III. IBs are an intentional creation of Congress

The IB exemption from the Bank Holding Company Act ("BHCA") was an intentional creation of Congress when it enacted the Competitive Equality Banking Act of 1987 (CEBA). This status was

[4] http://industrialbankers.org/wp-content/uploads/2018/10/IB_REPORT_BARTH_2018.pdf

National Association of Industrial Bankers | NEVADA BANKERS ASSOCIATION — INVESTING IN NEVADA TOGETHER | UTAH BANKERS ASSOCIATION

not a loophole or an accidental oversight. Congress made that decision in order to allow the continuing development of industrial banks, which were subject to regulatory oversight as banks but were owned by companies exempt from the BHCA's activity restrictions. In the 33 years since the enactment of CEBA, Congress has repeatedly visited and modified the regulatory structure for our nation's banks and chosen to leave the regulatory structure for IBs intact. Congressional intent in this area is clear. Gramm-Leach-Bliley, which ended commercial ownership of unitary thrift holding companies, left ILCs untouched. During negotiations over what became the Dodd-Frank Act, the Administration recommended removing the ILC exemption from the BHCA, but Congress chose not to do so.

IV. IBs are among the safest, strongest financial institutions in the nation

For decades, FDIC call reports have consistently confirmed that IBs are well capitalized, safe, and strong. This FDIC data shows that in comparison to commercial banks, IBs are better capitalized and are generally more profitable. The Utah Department of Financial Institutions (in prior testimony before the Task Force on Financial Technology) stated, "the Department calculates an average Return on Average Assets ratio of 1.04 percent for FDIC-insured depositories, whereas industrial banks average 2.48 percent." These numbers are not just a snapshot in time; IBs have consistently outperformed other banks in both ROA and capital-to-assets ratios for the past 35 years.

During the Great Recession, all but one IB survived (most remained profitable). The Federal Reserve did require several entities to close the operations of the IBs they owned as a condition of receiving TARP funding. All of these IBs were sound prior to the closure—none required assistance.

One reason for this is the added support a diversified parent can provide to its IB subsidiary. Unlike almost all commercial banks, most IBs have ready access to all the capital they may ever need. This has been demonstrated many times. IB parents enter into contracts with the FDIC that require the parent to contribute additional capital whenever the FDIC believes it is needed. Remarkably, a bank holding company regulated by the Federal Reserve is not required to contribute capital to a subsidiary bank and almost all have little or no ability to raise capital in any event. This is due to restrictions in the Bank Holding Company Act that prohibit activities not closely related to banking that eliminate any benefit from a parent holding other assets. As a result, most bank holding companies are shells that cannot serve as a source of strength to its bank. In the industry today, only the largest bank holding companies (because of their established presence in capital markets) and the diversified parents of industrial banks have any real ability to serve as a source of strength to a bank.

Yet, despite the incontrovertible evidence, there are voices who continually claim that IBs present a threat to the FDIC banking system. Please note that these allegations are frequently made without any documentation. **There is no evidence that disputes the strength of the IB model.**

V. IBs are highly regulated by federal and state regulators

The FDIC and state regulators have broad authority over both IBs and their parent companies to take any and all actions necessary to protect the bank, its depositors and the deposit insurance fund. The FDIC has frequently affirmed its authority to regulate the industrial banks and their transactions and relationships with their parents and affiliates.

National Association of Industrial Bankers
60 South 600 East
Suite 150, Salt Lake City, UT 84102
(801) 355-2821 | industrialbankers.org

Nevada Bankers Association
1001, E Sunset Rd #96513
Las Vegas, NV 89193
(702) 233-8607 | Nvbankers.org

Utah Bankers Association
175 South Main Street, Suite 1420,
Salt Lake City, UT 84111
(801) 364-4303 | utah.bank

First and foremost, the IBs are regulated by both their chartering state and the FDIC and must comply with all relevant safety and soundness regulations, and all consumer protection regulations.

Industrial Banks are regulated like every other FDIC-insured bank: subject to the Community Reinvestment Act (CRA), fair lending requirements, privacy laws, the full array of examinations, taxes, etc. The only difference is that an industrial bank parent and affiliates are regulated by the FDIC, instead of by the Federal Reserve, and can engage in other businesses separately from the bank. By every tangible measure, this regulatory approach has worked extremely well.

The FDIC's recent rulemaking to codify existing regulatory practices further highlights the agency's ample authority to ensure that the parent company of an IB, be it financial or commercial, does not pose a risk to the insured institution, the taxpayers or to the U.S. financial system. Both the state regulators and the FDIC have the authority to examine parents and affiliates for compliance with Federal Reserve Act Sections 23A and 23B and ensure that the IB and its parent interact in a safe and sound manner and that banking and commerce do not mix in any way that would produce an undesired impact on the economy or the community. They can also require that the parent serve as a source of strength to the bank should it become distressed. The regulators can examine the parent company's records and management of the IB as needed should concerns arise. Finally, as former FDIC Chairman Martin Gruenberg noted, the FDIC and the appropriate state banking regulator can limit the activities an IB can engage in with a parent or affiliate if they are concerned about those activities' impact on the institution.

Contrary to unfounded accusations made by some groups, the main reason a parent chooses an IB charter is because it is a diversified company that has opportunities to offer specialized financial services, in most cases to an established customer base. The Bank Holding Company Act did not envision these synergies and precludes the parent from pursuing a commercial bank charter because of the other businesses within the group. The main difference about regulation of IB parents and affiliates is that regulators do not regulate other business activities of a diverse group that are not relevant to the bank. The regulators do regulate the transactions and relationship between each IB and its affiliates, and have a broad array of authorities to ensure they are compliant and safe. The now more than 35-year history of modern IBs has proven the safety and effectiveness of this model. It is no exaggeration to say IBs are the safest and strongest banks insured by the FDIC.

Many critics also raise concerns about conflicts of interest between an IB and its affiliates but fail to understand how Sections 23A and 23B of the Federal Reserve Act—applicable to all industrial banks and their affiliates under provisions of the Federal Deposit Insurance Act—effectively prevent any such conflicts of interest. IBs operate as fully independent entities and can only engage in transactions with affiliates that benefit the bank.

The bottom line is that the FDIC demands the highest standards of operation and performance by industrial banks. The FDIC regularly and exhaustively examines industrial banks and parent companies. Assertions that industrial banks are not regulated by federal entities or somehow escape proper supervision are simply not true and many are intentionally misleading.

VI. Industrial banks' prior scrutiny

For decades, Senate and House committees, subcommittees, and task forces have examined and analyzed industrial banks' performance, safety, commitment to consumer protection, regulatory supervision by federal state authorities, etc. No evidence or documentation has ever

National Association of Industrial Bankers NEVADA BANKERS ASSOCIATION INVESTING IN NEVADA TOGETHER UTAH BANKERS ASSOCIATION

been submitted during these activities that show undue systemic or operational risks or dispute the factual statements provided in this letter.

Indeed, pursuant to the Dodd-Frank Act, the United States Government Accountability Office (GAO) conducted a comprehensive review of IBs. In 2012, the GAO issued a report on "Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions," which did not recommend any changes to federal law regarding IBs.

VII. Industrial banks do not pose a "systemic risk"

Twenty-seven IBs hold $180 billion in total assets, as compared to 5,831 other banking institutions. IBs are 0.4 percent of the total number of FDIC-insured institutions, or 1 percent of these institutions' total assets.

The industrial banks were the most stable banks insured by the FDIC during the recession. For more than 30 years, they have consistently been the best capitalized and most profitable banks in the nation. As a group, industrial banks proved safer and stronger during the recession than other banks. One small industrial bank that specialized in small business credit cards failed in 2010 due to heavy losses and business closures among its customers.

In contrast, 529 community banks failed between 2008 and 2015, each of which had a holding company regulated by the Federal Reserve. Further, a few of the largest commercial banks, also regulated by the Federal Reserve, would have failed without government assistance, which was given to them because they posed systemic risks. The systemically important financial institutions (SIFIs) did include some investment banks that had IB subsidiaries, but those industrial banks were sound and still operate today, except for one that voluntarily self-liquidated at no cost to the FDIC. In fact, industrial banks played no role whatsoever in causing the Great Recession. No industrial banks then or now originate or syndicate housing loans or have any other connection to housing finance, except for one IB that finances energy-related home improvements such as new windows.

VIII. IBs are innovative partners

The IB model allows for innovative but safe products for American consumers. Fintechs and other financial services companies continually seek partnerships with IBs to provide these services. These are partnerships that should be encouraged by Congress. In all cases, the regulators require the IBs to treat all loans the same, even if those loans are sold. The IB is responsible for full legal compliance, through advertising to servicing to collections, regardless of whether it holds the loan.

Also, some innovative financial services companies may seek an IB charter. The rules promulgated by the FDIC and state authorities make this extremely difficult and require a number of commitments from the parent company. Our associations fully support such rigorous demands. The IB model has worked because it is heavily regulated and requires high levels of capitalization. Yet, they remain innovative and flexible.

Some "fintech" companies have considered applying for an IB charter. One such company, Square, was recently approved for an industrial bank charter and federal deposit insurance. It is important to understand that this represents an opportunity only for a company with well-developed products and services that is ready to comply with the broad range of standards and requirements applicable to all banks to help ensure they operate safely. Companies in the early stage of development do not qualify. For various reasons, including the restrictions in

National Association of Industrial Bankers
NEVADA BANKERS ASSOCIATION
INVESTING IN NEVADA TOGETHER
UTAH BANKERS ASSOCIATION

Sections 23A and 23B, mega technology companies such as Amazon cannot own a bank that offer loans and other financial services to customers of an affiliate. Such large tech companies can offer a full array of banking services to their customers (the activities critics say pose a systemic risk to the economy and banking industry) only by partnering with an independent bank. Many companies have such relationships with banks.

IX. IBs benefit American consumers with safe innovative financial services

In summary, IBs are among the safest and soundest banks in the U.S. system, and they do not create systemic risk. What they do create is competition and innovation in the U.S. banking system. IBs are small, innovative, fully-regulated banks that help create and test new products for consumers and businesses.

Again, we appreciate the opportunity to submit this statement for the record and are grateful for the efforts of the Subcommittee members and staff. Please let us know if you have any questions or need additional information.

Sincerely,

Howard Headlee
President & CEO
Utah Bankers Association
hheadlee@uba.org
(801) 364-4303

Frank R. Pignanelli
Executive Director
National Association of
Industrial Bankers
frank@industrialbankers.org
(801) 558-3826

Phyllis Gurgevich
President CEO
Nevada Bankers Association
phyllis@nvbankers.org
(702) 233-8607

April 21, 2021

United States House of Representatives Committee on Financial Services
Subcommittee on Consumer Protection and Financial Institutions
2129 Rayburn House Office Building
Washington, DC 20515

Re: Hearing Examining “Banking Innovation or Regulatory Evasion?: Exploring Trends in Financial Institution Charters,” Held on Thursday, April 15, 2021 at 10:00 am

Dear Chair Perlmutter, Ranking Member Luetkemeyer, and Members of the Subcommittee:

My name is James Slazas. I am a financial services industry veteran who currently advises a broad spectrum of financial institutions including investment banks, central banks, regulatory agencies, exchanges, pension funds, (re)insurance companies, and hedge funds on blockchain strategy and cryptocurrencies. I want to thank the Committee for holding a hearing on the subject of ‘Banking Innovation and ‘Regulatory Evasion’.

My company, VaultLink (www.vault.link), provides a turnkey solution that banks can use to enable customers to hold cryptocurrencies in a safe and sound manner within the consolidated supervisory framework of the FDIC, OCC, and the Federal Reserve. I believe that a bank should offer a ‘walled-off garden’ approach to customers in a way that both avoids systemic risks but at the same time, does not push individuals to seek cryptocurrency exchanges or other less-regulated solutions to satisfy their interest in this new type of investment.

Our firm is committed to partnering with legislators and regulators. Recently, VaultLink spoke with the OCC Office of Innovation on our solution. We are happy to demonstrate how our technology platform works to the Subcommittee as a way of better informing your Members on policy decisions for cryptocurrencies existing within the banking system.

I want to thank the Subcommittee for pursuing these issues and urge the leadership to consider further hearings on this very important topic.

Best Regards,

James Slazas
js@vault.link
http://www.vault.link

Credit Union National Association
CUNA

Jim Nussle
President & CEO

Phone: 202-508-6745
jnussle@cuna.coop

99 M Street SE
Suite 300
Washington, DC 20003-3799

April 12, 2021

The Honorable Ed Perlmutter
Chairman
Subcommittee on Consumer Protection and Financial Institutions
House Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Blaine Luetkemeyer
Ranking Member
Subcommittee on Consumer Protection and Financial Institutions
House Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Perlmutter and Ranking Member Luetkemeyer,

On behalf of America's credit unions, I am writing regarding the hearing entitled, "Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters." The Credit Union National Association (CUNA) represents America's credit unions and their more than 120 million members.

CUNA appreciates the subcommittee's commitment to oversight of the financial services sector by holding this hearing. The scope of this hearing should lead the subcommittee to examine the legal framework and regulatory scope governing the oversight of traditional banks and other commercial businesses that are engaged in financial activity. Credit unions are concerned that non-regulated companies are engaged in financial activities by offering products and services that are traditionally offered by credit unions and banks. These non-bank providers often strive to offer these products and services without being subject to robust consumer protection laws and regulations in place for banks and credit unions.

CUNA Supports Oversight of Financial Technology Companies

We understand the attraction of financial technology companies (fintech) to consumers as they seem to create novel products and services at a rapid pace. Some of these products and services are truly new while others may be a repackage of mature products and services wrapped in a thin veneer of technology and supported by venture capital that allows for pricing that undercuts traditional service providers to rapidly gain market share. While credit unions welcome competition, we are concerned that many products and services offered by fintechs skirt state and federal consumer protection regulations by exploiting loopholes in regulations or entering into partnerships with banks where the fintech company is able to leverage a partner bank's regulatory structure to its advantage.

It would seem the solution to these problems would be a federal charter for fintech companies and that is exactly what the OCC has proposed in different forms. In 2016, the OCC proposed a Special Purpose National Bank Charter for Fintech Companies (fintech charter), which would allow fintech companies to engage in banking activities. The proposal is currently mired in litigation. Former Acting Comptroller of the Currency, Brian Brooks, attempted an end-around the courts by proposing a "payment charter," which appeared to be a national money transmitter license that preempts state licenses requirement and provides a possible onramp for nonbanks to directly access to the Federal Reserve's payment clearing system.

CUNA opposed the so-called payments charter and any changes to the national bank charter that would lead to entities offering financial services but subject to less regulation and providing less consumer protection than banks and credit unions. We believe the OCC should undertake an open and transparent process in considering new types of charters or even approving what appears to be traditional charters that fundamentally alter the banking landscape without full consideration of the impact on consumers and other stakeholders. This process was followed with the notice and comment rulemaking process for the fintech charter but has not been done with payments charter.

We continue to have serious concerns with banks partnering with fintechs for lending, especially when these relationships seem designed to avoid consumer protection laws. At the state level, there are licensing or registration requirements to operate within a state, state-specific interest rate limits, state-specific loan value caps, and other consumer protections. State requirements are largely enforced by state financial regulatory authorities and state attorneys general. Fintechs can use a bank as a lending partner to avoid many of the state-specific regulations, which rob state regulators of their ability to properly regulate financial activities.

In what looks like a blatant attempt to weaken state laws, in July 2020, the OCC issued a Notice of Proposed Rulemaking (NPRM) related to determining the "true lender" in partnerships between national banks and third parties, including marketplace lenders. Under the proposal, a national bank would be considered the true lender of the loan if, as of the date of origination, it is named as the lender in the loan agreement or funds the loan. CUNA has significant concerns with the "true lender" proposal as it could be exploited to promote "rent-a-charter" arrangements between payday lenders and national banks, which can be used to evade state restrictions on high interest rates or loan terms. We believe the OCC's proposal is not in the best interest of consumers and should be withdrawn. Instead, the OCC, in coordination with its sister banking regulators, should focus its relief efforts on facilitating and promoting the fair and reasonable loan options that are offered by local-community based lenders like credit unions.

CUNA has long held the position that similar products and services should be regulated similarly so that consumers protection runs with a product or service, not with the entity providing the products or service. Credit unions and banks are subject to most of the same consumer protection laws. While not perfect, these requirements do help protect consumers. Unfortunately, clever fintechs can use partnerships with banks and possibly a banking charter to avoid consumer protections with the approval of the OCC. The Committee should continue to stay focused on the OCC as their actions could cause irreparable harm to consumers and cause consumers to lose trust in the banks, which could also impact our member credit unions by association.

Ensure Financial Inclusion Through Credit Unions

One of the most important things that Congress could do to promote financial inclusion and ensure that access to financial services is equitable would be to ensure that federal law permits all federal credit unions to serve underserved areas. Severe economic disruptions wrought by the COVID-19 pandemic have had a disproportionate impact on lower-income Americans and especially on communities of color. That's why it is more important than ever that communities have access to a trusted, local financial partner. Credit unions are eager to be that partner, but archaic charter and field of membership restrictions prevent most from expanding more broadly to help those who are most in need.

Under current law, only multiple common bond credit unions are eligible to add underserved areas to their field of membership. If the policy goal is to ensure that all have access to affordable financial services, then the policy should not restrict a subset of member-owned, not-for-profit financial institutions from providing service to these communities.

Allowing credit unions to expand into underserved areas would help jump start economic recovery and advance communities throughout the nation by giving tens of millions of consumers access to member-owned financial services. CUNA conservatively estimates that this modest but meaningful reform of field of membership rules would produce first-year benefits for over one million consumers who now have no realistic, affordable options in the financial marketplace[1].

We hope the Committee will consider legislation that expands the opportunity to serve underserved communities to all federal credit unions to ensure access to affordable financial services is equitable.

On behalf of America's credit unions and their more than 120 million members, thank you for the opportunity to share our views.

Sincerely,

Jim Nussle
President & CEO

[1] Assuming first-year membership growth of 5% among credit unions with restricted fields of membership that are not currently operating in underserved areas and 2.5% growth among community-charted credit unions not currently in underserved areas.