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RFA Update: Payments

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<p>OUR VIEW</p>	<p>The pace of change in payments is increasing exponentially due to rapid technological advancement. In less than a decade, many of the questions posed by the Federal Reserve’s 2013 public consultation on improving the U.S. payment systems have been answered or have become moot. The 2010s and 2020s have birthed entire new categories of innovative payment methods, like the concept of a Central Bank Digital Currency (CBDC) and stablecoins - both of which have the potential to transform how the U.S. payments system operates. Congress and the regulatory agencies are trying to keep up, as they attempt to adapt existing laws and regulations to the evolving digital landscape, address growing consumer banking needs, and increase access to financial services.</p> <p>The COVID-19 pandemic didn’t just accelerate the digitization of businesses, it also illuminated gaps in the U.S. payments system. Globally, the shift towards a more technology-centric financial system gives U.S. regulators, lawmakers, and industry no choice but to adapt or be left behind. Certain regulatory efforts, including FedNow, fintech charters, and a U.S. central bank digital currency (CBDC) have all made considerable headway over the last two years, and lawmakers are also searching for ways to increase access to the payments system.</p> <p>While Members of Congress and regulators across the political spectrum hold unique, and often conflicting views on how to address certain aspects of payments policy, the overwhelming pace of new products and financial categories will keep policymakers focused on ensuring regulations are flexible enough to allow innovation but also meet the high bar of consumer protection established by the federal financial regulatory regime. And while many of the ongoing efforts in the payments space predate the current Administration, there has been a strong emphasis on enacting policies to expand financial inclusion to traditionally unbanked or under-banked communities from the Biden Administration and Congressional Democrats.</p> <p>Below we provide an update into various ongoing workstreams and topics of debate in Washington related to the payments system, as well as what to expect moving forward.</p>
<p>CENTRAL BANK DIGITAL CURRENCY</p>	<p>CBDCs</p> <p>Discussions around the potential development of a U.S. CBDC have recently become more frequent both in Congress and at the Federal Reserve. Even the White House waded into the CBDC debate in its Executive Order on Ensuring Responsible Innovation in Digital Assets, recommending that the Federal Reserve continue its CBDC research and experimentation (such as the BIS multi-CBDC settlement work). The growing interest by policymakers is a result of both the rising popularity of digital assets and growing concerns around U.S. national security and global competitiveness, particularly given China’s advancements in the space. Discussions on the topic, while frequent, remain in nascent stages, and prospects for the adoption of a U.S. CBDC seem years away. Federal Reserve Chair Powell has consistently said he views the Fed’s recent work on CBDCs as just the start of a conversation with Congress, and that the Fed would prefer legislative clarity before authorizing a CBDC. That said, efforts continue.</p> <p><i>Congress</i></p> <p>Both the Senate Banking Committee (SBC) and House Financial Services Committee (HFSC) have each held multiple hearings on CBDCs, with more expected this year. These hearings have been generally high-level, and while members have found them to be useful for educational purposes, no substantive ground has been broken at this point. While there is some bipartisan support for</p>

potentially issuing a U.S. CBDC, members of both parties have voiced concerns around cybersecurity, fraud, and consumer privacy. Likewise, divisions have not fallen strictly along party lines – we’ve seen disagreements within both parties – making advancing legislation challenging this Congress.

- Democrats have generally supported the creation of a CBDC. In 2020, House Democrats unveiled several COVID-19 related bills, one of which included plans for the development of a U.S. digital dollar. Senate Banking Committee Chair Brown (D-OH) introduced a similar bill in the Senate (see FedAccounts section below). Democrats have also supported studying the impact of a CBDC, especially as it relates to financial inclusion.
- Chair Brown has commended the Federal Reserve’s recent efforts to study a CBDC and has advocated for one that is designed through his [No-Fee account proposal](#). He has also raised concerns that the U.S. is falling behind on designing a CBDC and has criticized the threat of private actors “attempting to dominate the payment system.” Sen. Warren (D-MA) and other progressive lawmakers have made similar remarks on how a CBDC could help drive out the risks posed by “bogus digital money.” While some Democrats have been advocates for issuing a CBDC, other lawmakers, such as Rep. Torres (D-NY), have expressed skepticism, arguing that well-regulated, privately issued stablecoins could serve the same function. Rep. Auchincloss (D-MA) has also expressed some reservations about the domestic use case for a CBDC.
- Republicans have been particularly concerned that issuing a U.S. CBDC could hamper private-sector innovations in the payments space, especially stablecoins, with some skeptics calling it a “solution in search of a problem.” Some have also voiced concern that it would result in the Fed inappropriately competing with private banks. That said, other Republican lawmakers, such as Rep. Hill (R-AR), have been advocates for a CBDC with sufficient privacy protections and other considerations in mind. Legislative proposals to study a potential digital dollar have been introduced, but no clear consensus has been displayed at this point.
- Additionally, HFSC Republicans recently released a [set of principles](#) outlining how CBDC proposals should be evaluated. Some of these principles include fostering competition in the payments space and maintaining the dollar as the world’s reserve currency.

CBDC Legislation

There have been several bills introduced over the last few years related to either studying or implementing a U.S. CBDC. We outline a few of the more noteworthy bills from the 117th Congress below.

- Perhaps the most headlined bill is [H.R. 2211](#)- the *Central Bank Digital Currency Study Act of 2021*, introduced by **Rep. Foster (D-IL)**. The bipartisan bill would require the Federal Reserve to report on the impacts of the introduction of a CBDC on consumers, businesses, monetary policy, and the US financial system.
- [H.R. 6415 \(Rep. Emmer \(R-MN\)\)](#): prohibits the Federal Reserve from issuing a CBDC directly to individual Americans without Congressional oversight.
- [H.R. 3506](#), the *21st Century Dollar Act (Rep. Hill (R-AR))*: requires the Department of the Treasury to establish a strategy to ensure the U.S. dollar remains the reserve currency of the world. The bill also requires Treasury to submit a report that includes legislative recommendations and efforts by foreign central banks to create a digital currency.

Federal Reserve

The Fed released its anticipated (and much delayed) [CBDC Paper](#) in late January. While the report didn’t endorse any specific proposals or outline any policy positions, it did present a comprehensive view of the costs and benefits of issuing a CBDC.

- Most notably, the report stated that the Fed does not intend to issue a CBDC without clear support and guidance from the executive branch and Congress (ideally, through law). Fed Chair Powell (currently Chair Pro Tempore) has been open-minded on the idea of a CBDC but has repeatedly cautioned against rushing toward a solution. He has been clear that the Fed’s paper is only a starting point of an extensive process. Meanwhile, soon-to-be Vice-

	<p>Chair Brainard has strongly advocated for issuing a digital dollar, citing potential benefits to underbanked individuals and efficiencies to cross-border transactions. That said, while the Fed’s paper helped to advance the debate in Washington, its decision to push the responsibility onto Congress suggests an official U.S. digital dollar likely is not plausible in the near term.</p> <ul style="list-style-type: none"> • The Federal Reserve Bank of Boston and MIT also released a paper detailing the design for a potential U.S. CBDC. The project, codenamed <i>Project Hamilton</i>, described a theoretical high-performance and resilient transaction process for a digital dollar that could handle 1.7 million transactions per second. The paper also sought to address fears associated with a CBDC, such as privacy concerns and combatting money laundering. <p><i>International</i></p> <p>Central banks across the globe are exploring whether a CBDC can help to achieve certain economic objectives, like a resilient payments system, price stability, and establishing public trust in their currency. There are currently around 90 countries with ongoing CBDC-related initiatives at some level, with nine countries having moved to create a digital currency at this point. China and South Korea are both in pilot stages but are preparing for a possible full launch this year.</p> <ul style="list-style-type: none"> • This has raised the eyebrows of many in Congress who worry the U.S. has fallen too far behind from an international perspective, frequently citing China’s Digital Yuan. The role of the dollar as the world’s reserve currency will remain top-of-mind for all U.S. stakeholders as this issue is addressed.
STABLECOINS	<p>Stablecoins</p> <p>Congress and the federal financial regulatory agencies have increasingly discussed the merits and risks of stablecoins, especially after the release of the President’s Working Group (PWG) on Financial Markets Stablecoin report. The increased attention to the space is a result of both the rising popularity in digital assets and growing concerns that stablecoins could scale quickly enough to present financial stability risks and be an avenue for the movement of illicit funds.</p> <p><i>PWG Report</i></p> <p>The PWG report found that depending on how a stablecoin, or payment stablecoin arrangement, is structured, it can effectively fall outside the financial regulatory perimeter, creating substantial risk for U.S. investors and the economy. The report recommended that Congress enact legislation to ensure payment stablecoins, and payment stablecoin arrangements, are regulated on a consistent and comprehensive basis as insured depository institutions. While the report provided a comprehensive review of the current regulatory frameworks that exist and possible ways to address regulatory gaps, it is merely a recommendation on how to proceed with stablecoin regulation. Treasury officials have said that Congress will need to provide regulatory clarity on the matter.</p> <ul style="list-style-type: none"> • In separate SBC and HFSC hearings, Nellie Liang, the Under Secretary of the Treasury for Domestic Finance, underscored that the primary recommendation of the PWG report is for Congress to craft legislation on stablecoins –that federal agencies, and FSOC, do not have sufficient authority to act on their own. It is unclear whether there is enough common ground to advance any legislation at this point. That said, Rep. Gottheimer (D-NJ) recently circulated a discussion draft for his legislation, the Stablecoin Innovation and Protection Act, which seeks to designate certain digital currencies as “qualified” stablecoins if they can be redeemed on a one-for-one basis for U.S. dollars. Rep. Gottheimer’s discussion draft has received praise from trade groups like the Digital Chamber of Commerce for proactively consulting and engaging with industry. The bill is expected to be formally introduced in the coming months. • In these stablecoin hearings, Liang focused on the primary prudential concerns outlined in the report: run risk, payment system risk, and concerns around the concentration of economic power. She also recognized, somewhat in contrast with the report, that stablecoin issuers not participating in lending activity should not face the same regulatory regimes as banks. She indicated that additional guidance from the Administration on the matter is expected in the coming weeks and will focus on BSA/AML/KYC compliance.

	<ul style="list-style-type: none"> • Many Democratic members, including SBC Chair Brown, called for greater transparency into stablecoin reserves – suggesting many are not fully backed. Republican members generally focused on the potential benefits, such as price stability, increased payments speed, and lower transaction costs. SBC Ranking Member Toomey (R-PA) provided a guiding set of principles, that calls for tailored regulation for issuers not engaged in traditional banking services. It is worth noting that an argument we’ve heard made by lawmakers in both parties is that better regulation over stablecoins could replace the need for a U.S. CBDC.
FEDNOW	<p>FedNow Development of the FedNow Service has been in the works since 2019 and the Federal Reserve announced last year that the service’s core clearing and settlement functions will be accessible as early as 2023. The purpose of the FedNow Service is to provide 24x7x365 real-time payment services for financial institutions across the country, regardless of size or geographic location, thus providing individuals and businesses with quick access to their money. The benefits of immediate fund transfers are understood by both the financial services industry and regulators, although certain discrepancies with the program’s operational platform still need to be ironed out, including interoperability capabilities, how the service will co-exist with private-sector RTP systems and a pricing structure. As a result, the Fed has initiated a process that will continuously incorporate and adapt to industry feedback. Below are additional noteworthy developments in this space.</p> <ul style="list-style-type: none"> • Pilot Program: An ongoing pilot program comprised of a diverse set of over 120 banks, processors, and other financial institutions of all sizes was launched early last year. The program conducts bi-monthly educational sessions focused on the various features and functionalities of the program, and more importantly, allows for industry feedback to make necessary changes to improve FedNow before its 2023 debut. An example of an adjustment approved by participants is aligning FedNow’s message specifications with the international message standard used by payments systems around the world – ISO 20022. The group has also continued to underscore the need for interoperability to give access to smaller institutions. Participants will play a key role in shaping the service, defining the adoption roadmap, and ensuring industry readiness. • Pricing Approach: Earlier this year, the Fed announced information regarding its pricing approach for FedNow, ahead of the service fee schedule set to be published later this year. The announcement included a \$25/month FedNow service participation fee per routing number; a \$0.045 fee per credit transfer, paid for by the sender; a fee of \$0.01 for any payment requests; and an initial default credit transfer limit of \$100k. The full pricing structure is still being worked through, although it is important to remember that a government-run program cannot turn a profit and therefore could theoretically offer competitive pricing compared to private-sector payment systems. • FedAccounts: SBC Chairman Brown has pushed for legislation that would create FedAccounts - a free, widely available bank account run by the Federal Reserve that would be accessible at any post office, credit union, or bank, without “abusive fees.” Chair Brown introduced his legislation at the height of the pandemic, arguing that the digital dollar wallet would allow unbanked individuals to easily receive money, make payments, and take out cash. The bill was not incorporated in the final coronavirus relief package and has faced criticism from Republicans and other stakeholders. The bill, entitled the Banking for All Act, has yet to be introduced in the 117th Congress. We do not expect any Republicans to support the measure.
FINTECH CHARTERS & INTERCHANG E	<p>Special Purpose National Bank (SPNB) Charters for Fintech After years of litigation, the Court of Appeals for the Second Circuit reversed the Southern District of New York’s decision in <i>Lacwell v. Office of the Comptroller of the Currency</i>, granting the OCC the ability to issue SPNB charters to fintech firms. The dismissal, which took place in June of 2021, does not prevent future litigation on the matter, and any fintech company that applies for an SPNB charter should be aware that the issue has yet to be decided by the courts and will likely result in further litigation by state regulators. Additionally, Acting Comptroller Hsu has expressed concerns about allowing nonbanks, through SPNBs, into the banking system without sufficient oversight. In a</p>

recent speech, he outlined run-risk and regulatory arbitrage as the two main reasons why synthetic banking poses risks to the financial system. Hsu also shared his perspective on licensing and fintech charters at a recent HFSC hearing in May 2021, arguing that the OCC must coordinate with states and the other banking regulators to find ways to consider how fintech charters fit into the banking system. Regardless of the recently dismissed lawsuit, we find it unlikely that Hsu will allow SPNBs for fintech charters at this time.

- **Federal Reserve and SPNB Charters:** On May 5, 2021, the Federal Reserve released [proposed guidelines](#) for evaluating requests for accounts and payments services at the Federal Reserve Banks. The move from the Fed likely comes as a response to the increased number of requests from special-purpose state and federal charter applicants. While the guidelines remain high-level and broad at this time, it is noteworthy that the Federal Reserve is changing its position to consider allowing non-traditional banking institutions access to payments services at the Fed.

Interchange

While key legislators in this space, such as Sen. Durbin (D-IL) and Rep. Welch (D-VT), have made little to no public comments on the upcoming Visa/Mastercard credit card fee increase that is slated for implementation next month (after being delayed during the pandemic), merchant trade groups have begun to heavily lobby Congress to stave off the expected increase.

- The National Association of Convenience Stores recently launched a robust ad campaign targeting policymakers on the effects of interchange fees on consumers, small businesses, and the U.S. economy. The ads will be featured on social media and traditional media across DC.
- CFPB Director Chopra has also criticized the companies for their upcoming plan to hike interchange fees “at a time of inflation.” He also more broadly criticized the lack of competition in the space, arguing that many businesses can’t survive if they stop accepting Visa or Mastercard cards.
- Rumors have been circulating that Sen. Durbin has been actively courting Senate Republicans to sign onto legislation that would extend the Durbin Amendment to credit cards. While there has been little activity in the interchange space thus far, we expect that to change as April draws nearer. We could see Durbin and Welch urge Visa and Mastercard to not raise interchange fee rates for another year, similar to what they did last year.
- It is important to note that the Durbin Amendment, also known as Regulation II under the Dodd-Frank financial reform legislation, passed with Republican support in 2010. It is not a strictly partisan issue, and the retail trades have strong relationships with members on and off the House Financial Services and Senate Banking Committees. Seven Republican Senators that supported the original Durbin Amendment still serve in the Senate today: Sens. Burr (R-NC), Collins (R-ME), Crapo (R-ID), Graham (R-SC), Grassley (R-IA), Risch (R-ID), and Wicker (R-MS). That said, in 2011, there were efforts to modify the Durbin Amendment to make it easier on financial institutions. That effort, which had the support of some of the original supporters of the Durbin Amendment, such as Sens. Crapo, Risch, and Wicker, was unsuccessful. The issue has seemingly become more partisan in recent years.

Federal Reserve Proposed Rulemaking

The comment period on proposed changes to Regulation II by the Federal Reserve closed on August 11, 2021. The Board’s proposed [rule](#) would clarify that the requirement that each debit card transaction must be able to be processed on at least two unaffiliated payment card networks also applies to transactions where a physical card is not present. It also seeks to standardize and clarify the use of certain terminology, among other things. The Fed is responsible for promoting competition within the debit card market, pursuant to the Durbin Amendment. This is the first time the Federal Reserve Board has opened its original Durbin Amendment rulemaking since 2013 and we expect finalization of the rulemaking later this year.

CFPB 1033

CFPB 1033

By way of background, Section 1033 of Dodd-Frank provides consumers the right to access their financial data from financial institutions of which they are currently or formally a customer and allows

	<p>them to provide that information to other financial services providers that might offer competing products and services. This includes information relating to a transaction, series of transactions, or the account (i.e., costs, charges, usage data) and allows consumers to switch services more easily. Section 1033 has the potential to create innovation in financial services markets by creating portability of financial data, but it also could create new consumer risks.</p> <ul style="list-style-type: none"> • In November 2020, the Consumer Financial Protection Bureau (CFPB) published an advanced notice of proposed rulemaking to solicit information from the public regarding a new regulation to clarify standards around consumer-authorized access to financial data. This is the second time the CFPB had engaged with stakeholders on this topic. In October 2017, the CFPB published nine principles, some of which included consumer control and informed consent, data security and accuracy, and usability. • In July 2021, President Biden issued an Executive Order on Promoting Competition in the American Economy, which specifically called on the CFPB Director to commence rulemaking under Section 1033 to facilitate the portability of consumer financial transaction data. • Section 1033 rulemaking could impact financial data sharing developments in the future as questions loom about the extent to which the CFPB should determine data standards, such as application program interface (API). <p>The Section 1033 rulemaking is controversial and complicated because it could result in nonbank fintech firms and data aggregators falling under the supervision of the CFPB, as well as address the ability of these entities to obtain financial data through API and screen scraping. The CFPB published its latest semiannual regulatory agenda in the Federal Register on January 31, 2022, where they outlined a focus on various statutorily mandated rulemakings, including Section 1033. However, at this point it does not appear likely the CFPB will proceed to finalize a 1033 rulemaking in 2022.</p>
CFPB RFI ON JUNK FEES	<p>CFPB RFI on Junk Fees</p> <p>On January 26, the CFPB announced its request for the public to share its input on “exploitative junk fees charged by banks and financial companies.” The feedback will be used to help form the CFPB’s rulemaking and guidance agenda, along with its enforcement priorities in the coming months and years. The CFPB argues that the “fee economy” distorts the price of financial products and outlines several fees, such as overdraft fees, non-sufficient fund (NSF) fees, convenience fees for processing payments, and ACH fees, among other things. With Director Chopra at the helm of the CFPB, we expect additional action in this space in the coming year.</p> <ul style="list-style-type: none"> • The agency’s broad-brushed approach to this review fails to acknowledge that the permissibility of many of these fees is established by both state and federal laws. That said, we expect the CFPB to enhance its scrutiny of banks and other institutions that are reliant on these fees. It is possible that more nimble “unfair, deceptive, or abusive acts or practices (UDAAP)” authority may be used to set market-wide limitations through enforcement actions. • The CFPB has targeted financial institutions in the past regarding “junk” fees. In 2020, the CFPB ordered TD Bank to pay \$122 million in penalties and restitution. Recent settlements like this suggest that financial institutions should expect increased scrutiny from regulators in this area. OCC acting comptroller Hsu also recently commented on overdraft fees, arguing that they contribute to income and wealth inequality. It is clear the issue expands outside of just the CFPB, and we could see future action from the OCC as well once an official Comptroller is confirmed. • Additionally, the House Financial Services Committee is slated to have a hearing on overdraft fees at the end of the month entitled, “The End of Overdraft Fees? Examining the Movement to Eliminate the Fees Costing Consumers Billions.”
CFPB 1022	<p>1022 Requests – Tech and BNPL</p> <p>The CFPB recently opened two inquiries into 1.) large technology companies operating payments systems in the U.S.; and 2.) companies offering Buy Now, Pay Later (BNPL) services. The two sectors have come under increased scrutiny under Director Chopra’s leadership, and we expect</p>

DATA REQUESTS	<p>additional action by the CFPB as it exercises its statutory authority pursuant to section 1022(c)(4) of the Consumer Financial Protection Act.</p> <ul style="list-style-type: none">• Tech: In October, the CFPB issued orders to collect information on the business practices of six large technology companies: Amazon, Apple, Google, Facebook (now Meta), Square (now Block), and Paypal. The order also outlined that it would study the payments system practices of Chinese companies Alipay and WeChat. The CFPB plans to collect information related to data harvesting and monetization, consumer protections from fraud, data and privacy, and anticompetitive practices, among other things. Director Chopra was a fierce critic of big technology companies during his time at the FTC, and we expect him to use his bully pulpit to bring renewed scrutiny to the sector.• BNPL: In December, the CFPB issued orders to collect information from five companies offering BNPL credit to further understand the risks and benefits of this rapidly growing sector. The CFPB has raised concerns about “accumulating debt, regulatory arbitrage, and data harvesting” in the consumer credit market and has said it plans to coordinate with the Federal Reserve system and state partners to address this issue. We expect increased scrutiny in this sector in the coming year. Similarly, we have seen criticism from some Democrats in Congress that BNPL offerings exacerbate the debt cycle for certain consumers and warrant stricter regulatory guardrails. Republican members have generally supported BNPL as offering a different, and often times favorable payment option, although they have raised some concern around the protection of consumer data by these companies.
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