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# Fintech and Payments State-of-Play

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<p><b>OVERVIEW</b></p>	<p>Whether you are trying to manage your checking account, invest for retirement, or take out a mortgage, doing so has never been easier, thanks to the variety of channels you have for doing so and the ease of access digital platforms provide. The intersection of technology and financial services has created countless opportunities to increase access and efficiency across the financial services ecosystem, but these new products and platforms have inherent risks as well. New products and emerging technologies are being incorporated into almost all aspects of the financial services ecosystem, creating an ever-evolving regulatory landscape attempting to keep pace. The majority of the financial services regulatory regime was enacted long before most of the fintech products in the market today existed. Due to this, there is often uncertainty or mismatches when trying to apply the existing regulatory framework to emerging technologies. What often results is a push-and-pull scenario in Washington where regulators and elected officials position themselves somewhere between protecting the consumer at all costs and allowing space for innovation before a regulatory response. In this effort to balance consumer protection and innovation, how to regulate fintech is a complex and constant conversation in Washington.</p> <p>The Biden Administration has arguably skewed more towards the prioritization of consumer protections, but it isn't always a blanket classification by party. Currently, most of the congressional activity, especially among House Financial Services Committee (HSFC) Republicans, is in response to activity at the various regulatory agencies. Below we provide updates into ongoing workstreams and topics of debate in Washington related to fintech and payment platforms, as well as what to watch moving forward.</p>
<p><b>OUR VIEW</b></p>	<p>While the list of issues is long and a great deal of the action is occurring with regulators, we do not expect Congress to remain silent. We currently anticipate that the HFSC Subcommittee on Digital Assets, Financial Technology and Inclusion will focus on fintech in September with a high-level hearing, before focusing on specific issues and products in the financial services ecosystem. The Senate has also indicated an interest in many of the topics discussed below, including an AI initiative spearheaded by Majority Leader Schumer (D-NY), among items to watch in the fall. Additionally, there are a variety of rules at different stages in the notice and implementation process that will impact many of these fintech services, as well as new offerings like the just launched FedNow system.</p>
<p><b>EARNED WAGE ACCESS</b></p>	<p><b>Overview</b>  Earned Wage Access (EWA) or on-demand pay, is an emerging trend in payroll management that allows workers to access a portion of their already earned wages, outside of their employer's standard pay schedule. There are two primary models of product delivery – an employer-integrated model and a direct-to-consumer model. Both usually involve a digital or app interface. Direct-to-consumer models generally make revenue by charging the consumer an expedited transfer fee or requesting a voluntarily tip. There are different types of employer-integrated models. At a high level, some contract with and charge the employer to offer the service as part of the company's payroll service. Others operate by providing the service through employee-owned debit cards and then making money through interchange fees. With increased adoption of</p>

this service, offered by a variety of payroll management platforms, there has been debate as to whether or not this form of advanced payment should be considered a credit or loan and whether any associated charges, fees or tips should be subject to the Truth in Lending Act (TILA).

### Agency Action

In November 2020, the CFPB issued an advisory opinion to provide guidelines that prevent certain employer-integrated EWA programs from being considered credit under Regulation Z, which implements TILA. The 2020 advisory opinion was silent on direct-to-consumer models. In an effort to support the growth of EWA as it gained popularity, the CFPB also granted Payactiv a compliance assistance sandbox (CAS) approval [order](#) in 2020. These CAS orders were issued under the Trump Administration’s fintech sandbox program to allow companies to apply for no-action letters and were intended to promote innovation by decreasing the regulatory liability. In July 2022, at the company’s request, this CAS approval order was rescinded by the Biden Administration CFPB so they could change their fee model.

More recently, the CFPB has suggested that it may revisit the 2020 advisory opinion, following concerns from consumer advocates. These concerns included allegations of EWA services charging fees or “tips” in excess of state usury limits. Additionally, consumer advocates have alleged EWA fees or tips, when calculated on an annual percentage rate basis, are usurious. This was one of a few instances of uncertainty created by the 2020 advisory opinion cited by the current CFPB leadership. In January 2022, the CFPB General Counsel cited “these repeated reports of confusion caused by the advisory opinion due to its focus on a limited set of facts” and stated that he would recommend the CFPB do more to provide clarification. This uncertainty was again highlighted in a fintech [report](#) issued by the GAO in March 2023, that highlighted a lack of transparency of fees as a risk of EWA products. In a letter responding to the GAO’s findings, CFPB Director Rohit Chopra indicated that “the CFPB concurs with the GAO’s recommendation and intends to issue further clarification in this area.”

Additionally, in April 2022, the CFPB noticed that it intended to use authorities under the Dodd Frank Act (DFA) [Section 1024](#) to examine nonbank financial companies that pose risks to consumers. In a July 2023 [interview](#), CFPB Director Chopra has acknowledged that at least one EWA company is being supervised under this authority.

### What to Watch

Expect the CFPB to issue further guidance on these products – as soon as fall 2023. CFPB likely will look to supervise additional EWA providers under its nonbank DFA Section 1024 authorities. Legislation to exempt EWA products from TILA or to stop CFPB from labeling EWA products as credit or loans could be introduced this fall. However, while we do not expect any legislation to imminently become law, EWA could receive attention in HFSC hearings.

## BUY NOW PAY LATER

### Overview:

Buy Now Pay Later (BNPL) is a type of point-of-sale financing in the form of an installment loan that typically allows a customer to purchase something immediately with little or no initial payment and pay off the balance over four or fewer payments. While there are no interest charges, these products do charge late fees and each purchase using a BNPL loan involves a soft credit check. Without interest charges, these companies generate the bulk of their revenue from charging merchants. This generates a battle for users across BNPL platforms as it boosts value to merchants who are looking to maximize the number of users they drive to their platform.

### Congressional Action:

HFSC first took a look at BNPL in a November 2021 [hearing](#), under then Chair Waters (D-CA), entitled *Buy Now, Pay More Later? Investigating Risks and Benefits of BNPL and Other Emerging Fintech Cash Flow Products*. In December of 2022, HFSC Republicans sent a [letter](#) to CFPB Director Chopra, scrutinizing the CFPB’s approach to the BNPL industry. The cosigners criticized the negative tone of the press release and public comments, which were “casting BNPL in a skeptical

light,” that didn’t align with the report’s findings. They characterized this as pursuing name and shame tactics that the CFPB has used against other industries that they didn’t like.

To-date, there has not been significant legislative action on the issue, as Congress seems to be in more of a monitoring posture as the industry grows. That said, there is one bill in the House that would prohibit the use of BNPL for “semiautomatic assault weapons” purchases, but the chances of this bill advancing without a catalyzing event are slim.

- *HR 4829 - To prohibit BNPL loans for the purchase of semiautomatic assault weapons* – Rep. Larson (D-CT)

**Agency Action:**  
 The CFPB has been studying the BNPL industry as it has surged in popularity in recent years. In 2021, the CFPB issued a market monitoring [inquiry](#) requesting information from Affirm, Afterpay, PayPal, and Zip to “allow it to assess the impact on consumers of rising debt and the use of consumer data by the BNPL industry.” At the time, the CFPB listed accumulating debt, regulatory arbitrage, and data harvesting as concerns they wanted to better understand. The next step in the CFPB’s review included a request for public input in January 2022, seeking feedback from the public on their experiences with BNPL platforms.

In March 2023, the CFPB released a [report](#) based on the findings from these data collection efforts. While the CFPB’s public commentary was, as discussed above, more skeptical of the industry, the report’s findings were more balanced. The review of industry data found that “BNPL borrowers had higher credit card utilization rates and lower credit scores,” but did state that this difference pre-dated BNPL use. The report also found that “contrary to the widespread misconception, BNPL borrowers generally have access to traditional forms of credit,” and that the majority of BNPL borrowers would face 19-23% annual interest rates if using credit cards instead. In the end, the concluding concerns really seemed to focus on the rate of growth of the industry, as well as inconsistent consumer protections, data harvesting and monetization, and debt accumulation and overextension.

In July 2023, Director Chopra also acknowledged that at least one BNPL provider was subject to supervision and examination by CFPB under the nonbank authorities granted to CFPB by DFA Section 1024.

**What to Watch**  
 As we continue to see an increase in consumer credit card balances, it will be worth tracking how BNPL companies perform if consumer defaults increase. Any material increase here could quickly bring these products under significantly more regulatory scrutiny. Additionally, based on the CFPB discussion on the issue, it does seem that there is a focus on ensuring a baseline of consumer protection that is in-line with those of credit cards. Expect additional companies to potentially come under CFPB nonbank supervision and examination.

**PEER-TO-PEER (P2P) PAYMENTS**

**Overview**  
 P2P payments are the use of linked credit, debit, or bank account to make payments between peers, hold balances in digital wallets, and provide access to credit (product dependent). Popular platforms include Venmo, CashApp, PayPal, Zelle, and Google Pay. These services are popular thanks to the convenience of immediate money transfers on apps. The major risks associated with these platforms are the lack of recourse after a payment is authorized and the security of personal information.

**Congress**  
 The American Rescue Plan of 2021 changed the reporting threshold for third-party settlement organizations (TPSOs). The threshold for business transactions was moved from \$20,000 to \$600 per year – effective for the 2023 tax year – significantly increasing the number of taxpayers subject to reporting.

	<p>In April 2022, Sen. Elizabeth Warren (D-MA) issued a <a href="#">report</a> on Zelle and its owner and operator Early Warning Services, LLC (EWS), primarily focusing on P2P fraud. Warren alleged that Zelle and EWS did not repay most of the cases where customers were fraudulently induced into making payments on Zelle and that they did not repay the majority of customers who contest “unauthorized” Zelle payments. Warren called on CFPB to strengthen regulations to address instances of fraud under Reg E.</p> <p><b>Agency Action</b>                  In December 2021, the CFPB issued its latest <a href="#">FAQs</a>, detailing compliance standards for the Electronic Fund Transfer Act (EFTA) of P2P products under Regulation E. The FAQ confirmed the applicability of Reg E to P2P payments.</p> <p>In recent months, the CFPB has been active on P2P payments. In April, CFPB Director Chopra expressed that the Financial Stability Oversight Council (FSOC) should consider whether such money transmitter services should be designated as systemically important to ensure their customers' funds are adequately protected. In June, the CFPB published an <a href="#">Issue Spotlight</a> arguing that funds stored in P2P apps may not be safe in the event of financial distress, since the funds may not be held in accounts with federal deposit insurance coverage. The CFPB also issued a consumer advisory for customers holding funds in these apps and how they can make sure their funds remain safe. Just this month, Director Chopra indicated that at least one large technology company was undergoing examination and supervision pursuant to the CFPB’s DFA Section 1024 nonbank authorities.</p> <p><b>What to Watch</b>                  At the moment, there do not seem to be any major actions in this space and the risks around deposit security and inaccurate payment recourse are the main topics to watch. However, in the Spring 2023 rulemaking agenda, CFPB added a proposed larger participant rule focused on consumer payments markets, with a potential date of July 2023, although it is highly unlikely a proposal will be released this month (this proposal is discussed in more detail below). Expect potential addition nonbank supervision and examination of technology companies, especially in the P2P space.</p>
<p><b>CONSUMER PAYMENT MARKET – LARGE PARTICIPANTS SUPERVISION</b></p>	<p><b>Overview</b>                  As the payments space has grown, so has the number of non-traditional finance companies interested in the space. This extends beyond the platforms primarily focused on P2P payments to include major tech players like Amazon, Apple, Google, and Facebook. Their interest in the space caught the attention of the regulators as well, including the CFPB who have been monitoring the space and appear to be preparing to act as an agency after including “Supervision of Large Participants in Consumer Payment Market” on their agenda for this summer. Under the DFA, the CFPB has some ability to choose the nonbank companies it regulates through how it defines the consumer finance market in which it is interested.</p> <p><b>CFPB Action</b>                  In October 2021, the CFPB issued a series of Civil Investigation Demands (CIDs), under the CFPB’s Sec 1022 authority. These orders were sent to Amazon, Apple, Facebook, Google, PayPal, and Square, requesting information about the operations of their payment systems. The CFPB stated that the information would allow them to “better understand how these firms use personal payments data and manage data access to users.” While not responding solely to these specific CIDs, the CFPB’s increasingly common practice of issuing these requests, recently received scrutiny from Capitol Hill. In June 2023, a group of HFSC Democrats, led by Rep. Gottheimer (D-NJ) sent a letter to the CFPB concerning the disproportionate number of CIDs sent to nonbanks. Among concerns raised were the “unduly broad” scope of the requests and that they were based solely on the type of services provided, rather than objective evidence of conduct indicating a potential violation of the law.</p>

While a proposal has not yet been issued, the CIDs sent to the large tech players should be indicative of the CFPB's focus on how nonbank platforms are using the vast amounts of customer data to which they have access. While the P2P players, like Venmo, PayPal, and CashApp discussed above, are expected to be included, it is also possible that the CFPB could define the market in a way to capture the growing platforms at large firms, such as those they sent CIDs to. Other examples of the CFPB defining specific markets like this include debt collection, consumer credit reporting, and remittance transfers.

#### **What to Watch**

Until a proposal is released, we will not know exactly who is captured in this market as defined by the CFPB. Once a proposal is published, participants will have a better idea of who is covered and what standards the CFPB is attempting to apply. While there has been no noteworthy Congressional response yet, there is no doubt that such an attempt by the CFPB to expand their supervisory authority will garner attention and criticism from Republicans on Capitol Hill. It is also worth monitoring whether CFPB's usage of CIDs garners additional bipartisan criticism.

## **FEDNOW**

### **Overview**

Building on the idea of instant payments facilitated by P2P platforms, just this past Friday, July 21, the Federal Reserve (Fed) launched their own real-time payments service for financial institutions across the country. The Fed has been developing its FedNow service since 2019, including a pilot program involving 120+ banks and other financial institutions to test the system. The purpose of the 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. This is also intended to compete with the Real-Time Payments (RTP) Network introduced by The Clearing House in 2017; a private-sector real-time payments system established by the banks to clear and settle payments and eligible for use by all federally insured US depository institutions. The RTP system currently has ~350 users, while FedNow launched with just over 50 banks and credit unions.

### **Congress**

While the development and launch of FedNow is a Fed driven project members of Congress have often inquired about the need and use of such a platform when Fed governors have appeared on Capitol Hill for hearings. These questions of necessity focus on the fact that the private-sector has already developed an alternative with RTP, and has a 5-year head start, while the Fed system will not interface with RTP. In response to a question on this issue at a June HFSC hearing, Federal Reserve Chair Powell responded by pointing to "overwhelming" support from smaller community banks seeking an RTP alternative. Another concern from elected officials and market participants has been that FedNow could supercharge a potential bank run by facilitating fast outflows from financial institutions, a fear that was amplified after the failure of Silicon Valley Bank (SVB) earlier this year.

During the height of the pandemic and with FedNow's development in the background, Senate Banking Committee (SBC) Chair Brown (D-OH) pushed for legislation that would create FedAccounts - a free, widely available bank account run by the Fed that would be accessible at any post office, credit union, or bank, without "abusive fees." The bill was not incorporated in the final coronavirus relief package and faced significant criticism from Republicans and other stakeholders. This legislation has not been reintroduced in the 118<sup>th</sup> Congress.

- *S. 3571 Banking For All Act (116th congress)* – Sen. Brown (D-OH)

### **Federal Reserve**

In response to concerns raised about FedNow increasing the risk of bank runs, Cleveland Federal Reserve President Loretta Mester downplayed these concerns in a recent speech, arguing that banks have tools available to mitigate a wave of outflows.

	<p>Following the launch, the Fed is now focused on increasing adoption of the platform, which the Fed has acknowledged it expects to be gradual. “Over time, as more banks choose to use this new tool, the benefits to individuals and businesses will include enabling a person to immediately receive a paycheck, or a company to instantly access funds when an invoice is paid,” Fed Chair Powell said in a statement. While an increased user base will make the platform more attractive, the lack of support for cross-border payments or access for nonbanks will be items to watch to see if the Fed takes any steps to address these concerns.</p> <p><b>What to Watch</b></p> <p>With the rollout underway, we will monitor the success of this process, as well as the take-up rate in the market. Use of the system is optional, unlike the approach taken in some other countries, with many organizations currently only registered to use it in receive only mode. While there is currently no interoperability between FedNow and RTP, any future connectivity between the two would likely boost the take-up rate. Once FedNow usage becomes more wide-spread, it will be worth watching how merchants approach their more expensive, non-real-time, payment methods.</p>
<p><b>ARTIFICIAL INTELLIGENCE (AI) / MACHINE LEARNING (ML)</b></p>	<p><b>Overview</b></p> <p>The AI buzz is not exclusive to the tech and venture capital communities. As discussed in our recent <a href="#">piece</a> on AI, it seems all of Washington has taken notice, and based on President Biden’s comments on Friday, we should only expect this focus to continue in the months ahead. Many see the opportunities presented by AI, while simultaneously trying to address concerns about technology outpacing regulation, improper application, fraud, and other risks. Specifically related to financial services, there have been potential issues and scrutiny related to compliance with the Equal Credit Opportunity Act (ECOA), when ML and algorithms are relied upon for loan underwriting and eligibility decisions, including with many of the products discussed in this piece.</p> <p><b>Congress</b></p> <p>One of the most outspoken voices on Capitol Hill has been Leader Schumer. In June, he unveiled his high-level legislative framework for regulating AI, advocating for Congress to act with urgency or risk losing its chance to regulate the emerging technology. The framework, entitled the SAFE Innovation for AI Act, is made up of five pillars: Security, Accountability, Foundations, Explain, Innovation. Behind this push for regulation, Leader Schumer has highlighted risks including worker displacement, misinformation, and election interference, among others. We also expect that he will launch a series of AI forums in the fall, to engage top AI leaders, in an effort to speed up the legislative process on the topic.</p> <p>In the House, there has been a flurry of hearings and legislative proposals on the topic, a trend that we only expect to increase in the fall. Recently, Speaker McCarthy designated Rep. Obernolte (R-CA) as an AI leader for the Republican conference and on the House Energy and Commerce Committee (HECC).</p> <p><b>Administration Activity</b></p> <p>The focus on AI is far from exclusive to Capitol Hill.</p> <ul style="list-style-type: none"> <li>• <b>White House:</b> Chief of Staff Zients, is leading the Biden Administration’s strategy on AI and created a bipartisan working group on the topic. President Biden has held multiple meetings with major tech players in the space, and last Friday announced voluntary guidelines that had been agreed to by seven major tech players. These guidelines include things like the development of a watermark system for AI generated content, testing of security and capabilities before release, and researching the technology’s impact on society. President Biden also called for a bipartisan legislative response to the issue while indicating that his Administration is also developing an AI specific executive order.</li> <li>• <b>CFPB:</b> The CFPB released an issue <a href="#">spotlight</a> earlier this month criticizing the use of AI chatbots by financial institutions in banking, highlighting the number of consumer</li> </ul>

	<p>complaints received by the Bureau on the issue and warning that they could lead to noncompliance with federal consumer financial protection laws.</p> <ul style="list-style-type: none"> <li>• Just last week, the CFPB announced that Chopra will work with his European Commission counterpart to "identify emerging consumer threats in artificial intelligence, buy now/pay later and digital payments," to inform regulations and policies. This also will focus on "the impact of digitalization on financial services." The joint initiative will look at how new technologies and the financial products that they enable affect pricing, competition and customer privacy.</li> <li>• <b>FTC:</b> The FTC recently opened an investigation into OpenAI, which "primarily stems from a complaint against OpenAI filed by the Center for Artificial Intelligence and Digital Policy on March 30, 2023." Recurring themes in the complaint include "bias, harmful or offensive content, and the lack of transparency in how the large language model (LLM) works"</li> <li>• <b>CTFC:</b> The role of AI in financial markets was on the agenda for last week's Technology Advisory Committee meeting at the CFTC.</li> <li>• <b>Fed:</b> Speaking at the National Fair Housing Alliance conference last week, Michael Barr, the Federal Reserve's Vice Chair of Supervision, <a href="#">warned</a> of the potentially discriminatory consequences of too heavy a reliance on AI. <ul style="list-style-type: none"> <li>○ Barr highlighted the potential for AI to leverage alternative data sources in the digital economy to increase efficiency and access to credit, but warned that these technologies could also "perpetuate or even amplify bias or inaccuracies inherent in the data used to train the system or make incorrect predictions if that data set is incomplete or nonrepresentative."</li> </ul> </li> </ul> <p><b>What to Watch</b></p> <p>Given the current fascination with AI and its reach into almost every industry, we expect the news here to be continuous and stretch beyond the financial services regulators focused on the rest of the issues discussed. We anticipate the White House will issue an executive order on the topic prior to a legislative solution advancing through Congress. On Capitol Hill, we will be watching to see how Leader Schumer's proposal evolves and the timing of Senate consideration. Additionally, engagement with industry experts will be important here given the complexity and lack of familiarity with this emerging technology of most leaders in Washington. That said, agency research and monitoring of how these technologies are utilized in different industries, particularly those with large consumer exposure like finance and healthcare. Any indication of bias, misuse, or consumer harm will ensure heightened scrutiny and some form of regulatory response. We are expecting the SBC to enter the conversation with an AI hearing in September.</p>
<b>DATA PRIVACY</b>	<p><b>Overview</b></p> <p>A revision of data privacy standards has been a frequently discussed topic over the last decade however, most of the actual legislative progress has been at the state level. Last Congress, bipartisan legislation advanced out of the HECC, but failed to make it out of the House. After the change in control of the House, there seems to have been a bit of a reset of the legislative negotiations. While Republican's seem to be attempting to put their stamp on any proposal advancing out of the House, there is still bipartisan support for legislative action to revitalize data privacy standards. Congress will need to address the perennial stumbling blocks to enacting legislation including scope, private right of action, and preemption.</p> <p><b>Congress</b></p> <p>In the 117<sup>th</sup> Congress, there was ample bipartisan progress on comprehensive federal privacy legislation, with the <a href="#">American Data Privacy and Protection Act</a> (ADPPA) advancing out of the HECC in a 53-2 bipartisan vote. However, if failed to receive a vote on the House floor and will thus require reintroduction under new committee leadership. HECC Chair McMorris Rodgers</p>

(R-WA) alluded to a “new consideration” with the Republican control of the House but said letting Big Tech data issues and consumer harms to continue “isn’t acceptable.”

Earlier this year, the HFSC passed a data privacy [bill](#) along party lines to address the Gramm-Leach-Bliley Act (GLBA) components of the issue, but significant concerns were raised by HFSC Democrats, therefore giving us little faith this version could advance in a split Congress. A step forward for 2023 federal privacy law prospects came in March with the HEEC Subcommittee on Innovation, Data, and Commerce holding a hearing dedicated to privacy, during which lawmakers sought to prop up the ADPPA as the preferred framework to address current regulatory shortcomings.

**Administration/Regulations**

Privacy regulations are expected from several agencies, though in most cases exact timelines have not yet been announced. We currently anticipate regulatory actions, of particular interest to financial institutions and fintechs, to come from the CFPB and FTC. The CFPB is expected to issue a final rule in October for implementation of Section 1033 of the DFA, which the Bureau has indicated that it will finalize by 2024. The CFPB recently launched an inquiry into data brokers, requesting information from them as part of a potential rulemaking under the Fair Credit Reporting Act.

**State Privacy Laws**

As of July, momentum has reached an all-time high for state privacy laws, with nearly one-third of Americans living in states that have passed a comprehensive privacy law. More than a dozen state general assemblies have re-introduced comprehensive or data-specific privacy proposals, adding to the five states that already enacted laws. Currently, Colorado, Utah, Connecticut, and Iowa are set to join California and Virginia as states with comprehensive data privacy laws and regulations.

**What to Watch**

While this patchwork regime of state privacy laws should be expected to continue, a federal agreement still appears to need more time. In the House, until the HEEC advances their own proposal and pulls even with the HFSC product, full consideration should not be expected. Even if a proposal does advance out of the House, the partisan nature of the existing proposal leaves work to be done in the Senate. It will be worth watching to see if the Senate attempts to tackle privacy in the fall by broadening Leader Schumer’s AI package. While this AI legislation should be expected to have privacy provisions, such provisions beyond AI are not currently anticipated.

**BANK-FINTECH PARTNERSHIPS**

**Overview**

The relationship between banks and fintechs continues to evolve. The tension between competing and partnering has changed as new products have emerged, and the terms of various partnerships have changed based on the regulatory view at the time. Coming out of the Trump administration, True-Lender was the focus. With that gone, the focus has shifted to the guidance from the banking regulators on how to manage these partnerships. The current regulatory regime seems to coalesce around the idea that banking-as-a-service does not relieve the banks from compliance with any of the regulatory standards they must adhere to within their traditional banking business – fair lending, discrimination, disclosure, etc. It also makes clear that the banks are expected to properly review any partner firms and be accountable for their products/actions. Acting Comptroller of the Currency Michael Hsu has cautioned that bank-fintech partnerships are growing at exponential rates and that while he does not want to do away with these arrangements, he does want to make sure that risks are adequately understood.

**Congress**

In June 2021, President Biden signed a Congressional Review Act resolution to overturn the OCC’s “True Lender” rule issued in October 2020, by the Trump administration. This rule had attempted to make it easier for banks to partner with fintechs without running afoul of state



interest rate caps, but there were concerns that this would lead to consumer harm and excessive interest rates.

In October 2021, then HFSC Ranking Member McHenry (R-NC) led a [letter](#) to acting Comptroller Hsu urging Hsu to clarify the OCC’s position on partnerships between banks and financial technology firms and provide clarity to the marketplace.

**Agency Action**  
 Acting Comptroller Hsu has addressed this issue multiple times, including in an October 2021 speech entitled [Modernizing the Financial Regulatory Perimeter](#). In that speech, Hsu expressed concern about fintechs that were engaging in “synthetic banking” or essentially bundling the traditional banking activities of taking deposits, making loans, and facilitating payments. While Hsu was vague about how he intended to force activities within the OCC’s regulatory perimeter, he indicated that modernizing the bank regulatory perimeter cannot be accomplished by simply defining the activities that constitute “doing banking,” but will also likely require determining what is acceptable in a bank-fintech relationship.

When it comes to these partnerships and banking-as-a-service providers, actions by regulators have made it clear that the banking partner must focus on regulatory compliance when evaluating a potential partnership. For example, in March of this year, the FDIC took enforcement action against Cross River Bank (Cross River), alleging unsafe and unsound practices related to compliance with fair lending laws that largely implicated the bank’s fintech relationships through which it offered “banking-as-a-service” products. FDIC issued a consent order after finding that Cross River, and its affiliate Freedom Financial Asset Management, violated fair lending practices. The consent order cited FTC section 5 on unfair and deceptive practices as well as TILA and EFTA, related to the marketing and origination of an unsecured debt consolidation loan product. Cross River settled in March.

In June, new interagency [guidance](#) was issued by the Fed, OCC, and FDIC, on principles for risk-management for banks to follow when establishing and managing third-party relationships. This new guidance supersedes guidance on the topic previously published independently by the three regulators, while broadening the scope of relationships covered. The OCC continues to monitor bank-fintech relationships and Hsu has indicated that as arrangements, and risks, are better understood, the OCC will look to use its authorities to address potential concerns.

**What to Watch**  
 On a higher level, there is also a natural tension, particularly among Republican members, between supporting innovation and supporting community banks. The large players are best positioned to partner with emerging fintech platforms or develop their own, while the community banks claim that they are unable to compete given resources and scale. Additionally, it is worth noting that partnerships with fintechs using AI could attract more attention as regulators focus on ML and the potential to exacerbate bias or inaccuracies. Expect the OCC to continue to assert regulatory scrutiny over banks engaging with fintechs – especially facilitating taking deposits and lending. The HFSC is expected to examine bank fintech relationships in a hearing in the fall.

**DODD-FRANK  
 ACT SECTION  
 1033  
 RULEMAKING**

**Overview**  
 The DFA included a provision intended to ensure consumers have control over their finances in what is often referred to as “open banking.” This is supposed to increase financial freedom for consumers and ensure large financial institutions offer competitively priced products. The rule would do so by requiring banks to share transaction history and other financial data with the consumer and any third-party platforms, as authorized by the consumer. This includes competing banks and credit card companies, as well as fintech platforms, including online lenders, payment apps, and budgeting platforms.

	<p><b>Agency Action</b></p> <p>The CFPB has been working towards implementation of DFA Section 1033. In 2022, the CFPB outlined various <a href="#">proposals</a> under consideration for the formal rulemaking process. Given the potential impact on many small businesses, the CFPB was required, under the Small Business Regulatory Enforcement Fairness Act (SBREFA), to convene the Small Business Review Panel, to assess the proposal’s impact on small entities. This panel submitted its final report in March and the CFPB is now expected to issue a formal proposal for public comment in October according to the Bureau’s Spring 2023 regulatory <a href="#">agenda</a>. Director Chopra reiterated the October timeframe in a recent congressional hearing and a June blog <a href="#">post</a> and additionally stated he expects the Bureau to finalize the implementation in 2024.</p> <p><b>What to Watch</b></p> <p>We expect the proposed rule to be published for comment in October, followed by a 60-day public comment period. Specific to this proposal, we will be looking for provisions related to consumer control and their ability to transfer their financial history between banks, as well as required permissions related to third-party data access. Other topics of interest for the industry participants on both sides of the issue include what data is required to be made available and to which types of data aggregators and fintechs. Based on some of the proposals previously released by the CFPB, third parties should expect limits on the sale of consumer data. The HFSC is also expected to examine the issue as part of hearings in the fall.</p>
<p><b>CENTRAL BANK DIGITAL CURRENCY (CBDC)</b></p>	<p><b>Overview</b></p> <p>While there is no imminent plan to create a CBDC in the U.S. - Congressional authorization would be needed - the topic has received increased attention. To date, efforts have been focused on research and experimentation while others debate the necessity and concerns involving privacy, global competitiveness and more. A CBDC would be the liability of the Fed, unlike the majority of money today, which is held digitally and the liability of the bank. Primary concerns on the issue involve privacy and global competitiveness, while fraud and consumer privacy have also been mentioned. The concerns about privacy have really caught on recently, with a CBDC viewed as another way to increase surveillance, and in a more extreme scenario control, as this would effectively generate a centralized record of individual transactions. The other major factor is ensuring global competitiveness as China and other <a href="#">countries</a> advance their own research and pilots in this space.</p> <p><b>Congress</b></p> <p>Recently, Republican skepticism seems to have increased, but this position is by no means unanimous. Previously, HFSC Republicans released a set of <a href="#">principles</a> outlining how CBDC proposals should be evaluated. These principles included fostering competition in the payments space and maintaining the dollar as the world’s reserve currency. To this effect, members have also introduced legislation supporting research, particularly emphasizing the focus on global competitiveness.</p> <ul style="list-style-type: none"> <li>• <i>HR 556 21st Century Dollar Act</i> - Rep Hill (R-AR) – Would require Treasury to establish a strategy to ensure the dollar is the primary reserve currency and issuing a report to Congress detailing the necessary strategy and recommendations.</li> <li>• <i>HR 1122 CBDC Anti-Surveillance State Act</i> – Rep Emmer (R-MN) with 40+ cosponsors, would prohibit the Fed and FOMC from using any CBDC to implement monetary policy or offer related CBDC products and services to individuals.</li> <li>• <i>S. 967 No CBDC Act</i> - Sen Lee (R-UT) – Similar to HR 1122, prohibits the Fed and other Federal agencies from issuing or using a CDBC.</li> </ul> <p>It should be noted that Republican members of Congress are increasingly feeling pressure from conservative and other groups to oppose any CBDC. For example, <a href="#">some commentators have posited</a> that US implementation of a CBDC could be akin to allowing China’s social credit system that surveils customer purchases and gives them a “score” to take root in the United</p>

States. This sentiment is increasingly taking hold among the conservative elements of the right flank of the House Republican conference and will make any federal government activity in this space an uphill climb among Republicans.

Democrats have generally supported the study and creation of a CBDC, focusing more on CBDCs as a way to expand access and promote financial inclusion. Similar to Chair Brown's efforts on FedAccounts during the height of COVID, in 2020, House Democrats unveiled legislation that included plans for the development of a U.S. digital dollar. In the Senate, Chair Brown has commended the Fed's recent efforts to study a CBDC and has advocated for one that is designed through his No-Fee account proposal (mentioned in FedNow section). He has also echoed 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."

- *H.R.2211 Central Bank Digital Currency Study Act (117<sup>th</sup> Congress)* – Rep. Foster (D-IL)

### **Administration**

In March 2022, the White House waded into the CBDC debate with its [Executive Order](#) on Ensuring Responsible Development of Digital Assets (EO), recommending that the Fed continue its CBDC research and experimentation, while requesting responses from nine government agencies on the topic. The Administration's outlined policy objectives for a US CBDC system included: protect consumers, promote economic growth, improve payment systems, provide interoperability with other platforms, advance financial inclusion, protect national security, respect human rights, and align with democratic values. National Economic Council Director Lael Brainard has previously advocated for issuing a digital dollar, citing potential benefits to underbanked individuals and efficiencies to cross-border transactions.

### **Federal Reserve**

While the Fed has not issued a final recommendation about issuing a CBDC, they have been researching it for a few years. Prior to the Administration's EO, the Fed [issued](#) *Money and Payments: The U.S. Dollar in the Age of Digital Transformation*, as a first step in fostering a broad and transparent public dialogue about CBDCs in general, and their potential benefits and risks. Fed Chair Powell has consistently reiterated that this is a Congressional decision, including in his March testimony before the HFSC, when he stated that a CBDC is "something we would certainly need Congressional approval for."

### **Treasury**

As a further sign of increased consideration of CBDCs, in March, Undersecretary of Domestic Finance Nellie Liang announced the formation of an Interagency Working Group on CBDCs, "intended to complement the Fed's efforts. The identified main objectives for the group include how a U.S. CBDC could contribute to and sustain U.S. global financial leadership; potential national security risks posed by a CBDC; and the implications for privacy, illicit finance and financial inclusion if a CBDC were to be created. Liang cited the central bank's role "at the heart of the global monetary system," and its position as the "backbone" of the payments universe as reasons to explore CBDC in an environment where money and payments are always changing.

### **What to Watch**

The opposition to a CBDC seems to be gaining steam, particularly in conservative and libertarian circles where privacy concerns seem to be spreading quickly, making Congressional approval doubtful in the near-term. Just recently, it was mentioned on the 2024 campaign trail when Gov. DeSantis (R-FL) promised to ban a CBDC if elected President. However, the concerns around global competitiveness, particularly China seem to be a bipartisan concern. If consensus builds that the United State's position as the primary reserve currency is challenged due to the lack of a CBDC, this would likely impact the Fed's approach to the issue and increase the odds for Congressional action.

<p><b>COMMUNITY REINVESTMENT ACT (CRA) REWRITE</b></p>	<p><b>Overview</b> Just like the discussion of a revised framework for bank mergers, addressed in our last <a href="#">state of play</a>, the CRA has been a focus of reform efforts in response to the evolving digital nature of the banking industry. The CRA is a 1977 law passed to address redlining practices. It requires banks to detail how they lend in low-income areas and last saw significant reforms in 1995, when banking involved a much more physical footprint than it does today. In May, the OCC, FDIC, and Fed released a proposal to modernize the CRA.</p> <p><b>Congress</b> At the moment, this process is under the control of the regulators, however, commentary and questions from Capitol Hill should be expected as the public comment period comes to a close. That said, in the prior Congress, the HFSC Subcommittee on Consumer Protection and Financial Institutions, held a <a href="#">hearing</a> entitled <i>Better Together: Examining the Unified Proposed Rule to Modernize the CRA</i>. Legislation on the topic was also discussed around this hearing, but has not been reintroduced this Congress.</p> <ul style="list-style-type: none"> <li>• <i>HR 2768 American Housing and Economic Mobility Act</i> – Rep. Cleaver (D-MO)</li> <li>• <i>HR 8833 Making Communities Stronger Through the Community Reinvestment Act</i> – Rep. Waters (D-CA)</li> </ul> <p><b>Administration</b> The last attempted changes to the CRA were issued in May 2020, under Trump-era OCC Comptroller Joseph Otting, who pushed a revamp of the rule that the Fed and FDIC never supported. This rule was later rescinded by OCC Acting Comptroller Hsu.</p> <p>Digital banks are clearly a target for Biden Administration regulators as a key focus of the proposed CRA regulations would be to bring banks that lend nationally but do not have branches under the CRA, even though they do not generally take in local deposits. The currently pending <a href="#">proposal</a>, put forward by the OCC, FDIC, and Fed for comment, would subject banks to up to four tests, depending on size. These tests include, retail lending, retail services and products, community development financing, and community development services. Community development “would include investments in childcare, education, workforce development, job training, health services, financial literacy efforts and revised parameters for affordable housing.” For large banks (&gt;\$2bn in assets), these community development activities could be considered as a nationwide metric. Small (&lt;\$600mn in assets) and midsized banks (&lt;\$2bn in assets), could choose between the new or old standards to test their compliance. Additionally, in an effort to address the existing branch-centric “facility-based assessment areas,” the new proposal would add concentrations of mortgage and small business lending to the review for large banks.</p> <p><b>What to Watch</b> Comments are due on the CRA proposal on August 5<sup>th</sup>, after which we will follow along to understand how the collective regulators respond to the feedback. We also expect the HFSC to examine this proposal through a congressional hearing in fall 2023. It should be expected that Democratic members will push for any CRA reform to cover digital banks and support those elements of the current proposal.</p>
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