Treasury Issues Report Outlining Policy Priorities for Nonbank Institutions and FinTechs

Overview: On July 31, the U.S. Department of Treasury (“Treasury” or “Department”) released a 222-page report (the “Report”) that makes no less than 81 recommendations for creating a regulatory environment that supports responsible financial innovation and emerging financial technology (“FinTech”) services. The Report, titled “A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation,” is the fourth and final publication issued under Executive Order 13772, under which President Trump directed the Treasury Department to identify the extent to which existing laws promote—or inhibit—the current administration’s Core Principles for the U.S. financial system.

Just a few hours after the Report was released, the Office of the Comptroller of the Currency (“OCC”) took to heart its recommendation for the agency to finalize its proposal on Special Purpose National Bank charters for FinTech companies.

The Department drafted the Report after consulting with myriad stakeholders, including public and private sector actors that work in financial data, lending, payments, credit servicing, FinTech, and financial innovation. According to Treasury, the Report’s recommendations are designed to:

• “Embrace the efficient and responsible use of consumer financial data and competitive technologies;
• Streamline the regulatory environment to foster innovation and avoid fragmentation;
• Modernize regulations for an array of financial products and activities; and
• Facilitate ‘regulatory sandboxes’ to promote innovation.”

Below is an overview of some of the Report’s recommendations and directives to regulators and policymakers.

Standardize State Licensing Regimes. States should continue working to build a more unified process for licensing and supervision of money transmission, lending, and other financial services companies across the states. Such harmonization would help reduce the high operational and financial costs attendant to the currently fragmented state-regulatory landscape. More specifically:

• State uniformity should be promoted by, for instance, adopting a “passporting” license regime that allows a licensee in one state to have its home state’s license accepted by other states within a reciprocity pact.
• States may also seek to encourage drafting of model laws by the Uniform Law Commission that would govern money transmission and non-bank lending. To date, model law efforts in this space have not led to widespread state-by-state adoption of such laws.

• If states do not achieve such harmonization, Congress should act on its own to develop such uniformity.

It is important to note that, under the auspices of a FinTech working group, the Conference of State Bank Supervisors has already commenced an initiative to promote standardization of key money transmitter licensing elements. To date, a handful of states have agreed to such standardization.

**Adopt Regulatory Sandboxes.** Regulatory sandboxes should be established to facilitate experimentation for innovative financial products, services, and processes, while also providing oversight and monitoring of such innovations for regulatory compliance. Meaningful real-world experimentation without fear of enforcement, as well as frequent engagement by regulators, would benefit not only an innovating company, but also the regulator seeking to better understand a new product. More specifically:

• Treasury will work with federal and state regulators on a unified sandbox initiative that promotes innovation and technological transformation, provides targeted relief across multiple regulatory regimes, and maintains consumer protections. Congress should also consider authorizing a federal regulatory sandbox that cuts across financial regulatory agency lines, including preemption of state laws, if necessary.

• More generally, regulators should engage more frequently and be more accessible to the private financial sector to test and understand new technologies and innovations as they arise.

• As innovations occur, financial regulators should periodically review existing regulations to determine whether they still fulfill their original purpose in the least costly manner.

Soon after the release of the Report, the Bureau of Consumer Financial Protection Bureau (the “Bureau”) announced that it is beginning to work with 11 other foreign financial regulators to create a Global Financial Innovation Network (“GFIN”). The GFIN aims to create a framework for cross-jurisdiction cooperation between the regulators on FinTech topics. It appears the ultimate goal is some sort of global sandbox for companies to test FinTech products/services across borders and to ensure international collaboration on regulatory best practices. The Bureau and the other GFIN members are seeking comments on the network’s mission, function, and priorities.

**Improve Payments Regulation.** Regulators should aim to streamline and update payments regulation to improve payment speed, payment security, and the pace of innovation related to back-end payment processing. Latent demand for faster payments could be spiked by new technology and infrastructure, similar to the UK’s experience, “where technology allowed for a shift to a ‘just in time’ product delivery model that lessened the need for excess small business working capital.” More specifically:

• Along with its current effort to reassess Regulation E, the Bureau should provide more flexibility on issuing Regulation E disclosures for money transfers.

• With respect to payments speed, the Federal Reserve should set public goals and corresponding deadlines consistent with the findings of its Faster Payments Task Force. The agency should move quickly to facilitate a faster retail payments systems—for instance, by developing a real-time settlement service—that would also allow more efficient and ubiquitous access to innovate payment capabilities.

• With respect to payment security, the Federal Reserve should engage stakeholders to identify payment system resiliency as new systems come online and to help counsel the agency as it works to potentially develop its own faster-operating payments system.

**Streamline Oversight of Third-Party Service Providers.** Regulators should harmonize guidance for banks’ third-party service providers to promote efficiency and encourage technological innovation. Currently, regulation and guidance related to such oversight is mired in duplications, inconsistencies, and compliance costs that disproportionately affect smaller and less mature FinTech startups and other innovative companies. In particular, federal agencies should coordinate a review of current guidance related to third-party service
providers to ensure that both agency examination and bank oversight of such third parties is appropriately tailored and risk-based.

**Enact Federal Data Security Laws.** Congress should enact legislation on data security and data breaches that preempts state data breach notification laws.

**Modernize the Lending Regime.** Treasury takes a pro-marketplace lender view, with multiple recommendations addressing the central policy issues affecting marketplace lenders today. For instance, the Department encourages Congress to codify the “valid when made” doctrine and “true lender” concept, both of which complement recent congressional action. Notably, Treasury also recommends that the Bureau rescind its payday lending rule and that other regulators promote new credit modeling approaches by providing regulatory clarity.

**Outlook:** The Report provides significant clarity and direction from Treasury on how the administration intends to promote innovation in the financial sector. Still, it remains to be seen how—and if—its recommendations will be implemented by policymakers, especially those in Congress. An estimated two thirds of the recommendations are intended to allow regulators to enact them directly, while the remaining third would require action by Congress. At the very least, the Report provides a comprehensive framework to effectuate substantial modernization of the U.S. financial system.

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