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United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

July 21, 2016

The Honorable Janet Yellen
Chair
Board of Governors, Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

The Honorable Thomas J. Curry
Comptroller
Office of the Comptroller of the Currency
250 E Street, SW
Washington, D.C. 20219

The Honorable Martin Gruenberg
Chair
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

The Honorable Rick Metsger
Chair
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

The Honorable Richard Cordray
Director
Consumer Financial Protection Bureau
1700 G Street, NW
Washington, D.C. 20552

Dear Chair Yellen, Comptroller Curry, Chair Gruenberg, Chair Metsger, and Director Cordray:

In recent years, financial technology firms (“fintech”) have expanded their presence and products in the financial system. Market analysts have stated that “over \$4.7 trillion of revenue at the traditional financial services companies [is] at risk for disruption by the new, technology-enabled entrants.”¹ The World Economic Forum has stated that “this trend has the potential to become a game changer for small businesses.”² A number of new companies offer a diverse range of products and services, from alternative payment services, mobile payments, small business or consumer loans, and cash advance products. They may also be structured differently in terms of holding risk on their own balance sheets, partnering with financial institutions, or connecting capital from institutional investors to individual borrowers.³

We appreciate that your agencies have made public comments on the role of fintech in the financial system, and we applaud you for the steps your agencies have taken to date. Your conferences, white papers, and speeches have been productive and instructive as we learn more about these companies and their products.

¹ Goldman Sachs, *The Future of Finance Part 3: The Socialization of Finance* (Mar. 13, 2015).

² World Economic Forum, *The Future of Fintech: A Paradigm Shift in Small Business Finance* (Oct. 2015), http://www3.weforum.org/docs/IP/2015/FS/GAC15_The_Future_of_FinTech_Paradigm_Shift_Small_Business_Finance_report_2015.pdf.

³ For a list of prominent fintech companies and how they are structured, *see, e.g.*, Milken Institute Center for Financial Markets, U.S. Online, Non-Bank Finance Landscape (May 2016), <http://www.milkeninstitute.org/assets/PDF/Online-Non-Bank-Finance-Landscape.pdf>.

As we think about the role of fintech, we must be mindful that some of these products, activities, and business models may be new and innovative, while others may largely resemble those of existing, federally regulated firms. We write to seek more information about the tools the regulators have to ensure effective oversight over fintech companies. Recently, in the 2016 Financial Stability Oversight Council (FSOC) Annual Report, FSOC identified financial innovation and migration of activities as an area that “merit[s] special attention from financial regulators who must be vigilant to ensure that new products and practices do not blunt the effectiveness of existing regulations or pose unanticipated risks to markets or institutions.”⁴

As Congress considers its role in overseeing fintech and its impact on American consumers, we believe it is important that Congress better understand the way federal regulators oversee fintech and their relationships with federally regulated financial institutions. We offer a summary of the issues that we have heard from various stakeholders, and would appreciate your views on these issues as fintech becomes integrated into the financial system.

Diverse Business Models

Comptroller Curry has noted that the Office of the Comptroller of the Currency (OCC) is open to offering a charter to fintech companies, including a “limited charter.”⁵ Researchers suggest that there are at least 4,000 fintech firms providing financial services directly to consumers or small businesses, or services to financial institutions.⁶ As a comparison, there were 5,289 commercial banks with FDIC insurance as of March 21, 2016.⁷ Fintech business models can vary greatly from the types of products offered, to whom the products are offered, and how the companies are financed.

Some fintech companies have formed formal partnerships with financial institutions while others may interact with depository institutions less formally, such as through the payment system. Some companies aim to form partnerships with small community banks and credit unions, while some small financial institutions have voiced concerns that they view fintech companies as competitors. Some fintech companies sell loans or securities to financial institutions.

Please describe: what your agency has done to study and understand the various types of fintech companies involved in marketplace lending, alternative payments, consumer lending, blockchain and distributed ledger, virtual currencies, personal finance management, robo-investing or saving, small business financing, merchant cash advances, education financing, crowdfunding, or invoice financing; your agency’s role in supervising or regulating these firms, including what considerations should be given to enabling non-bank companies to obtain a full or limited federal banking charter; and your views on the impact of these firms on the institutions you regulate.

⁴ FSOC 2016 Annual Report, <https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%202016%20Annual%20Report.pdf>.

⁵ Comptroller Thomas J. Curry Remarks at the Harvard Kennedy School’s New Directions in Regulation Seminar (Mar. 31, 2016), <http://www.occ.gov/news-issuances/speeches/2016/pub-speech-2016-39.pdf> (“Throughout our 150-plus years, the OCC has been willing to let the national bank charter adapt to our nation’s changing economic needs. I think our white paper on innovation will continue that tradition, opening the door to change without neglecting risk management”).

⁶ The Economist, Why Fintech Won’t Kill Banks (Jun. 16, 2015), <http://www.economist.com/blogs/economist-explains/2015/06/economist-explains-12>.

⁷ <https://www5.fdic.gov/SDI/SOB/>.

Regulation of third-party service providers

One way to consider oversight of fintech is as third-party service providers to financial institutions. Some fintech companies are third-party service providers. The banking agencies have authority to regulate and examine third-party service providers to the same extent as if the activities were performed by the financial institution itself.⁸ Under the Bank Service Company Act, the OCC, FDIC, and Federal Reserve may issue regulations, take enforcement actions for violations of law, and examine bank service companies. The CFPB has separate authority to regulate affiliated service providers that “provide a material service” to entities offering or providing consumer financial products or services, as well as authority to regulate a service provider to the extent that the service provider offers its own consumer financial product or service.⁹ The agencies have issued guidance about regulatory expectations for management of third-party relationships.¹⁰ This guidance generally requires financial institutions to assess risk of third parties, and conduct due diligence and ongoing monitoring.

Recent events raise questions about the relationship between regulators, financial institutions and third-party service providers, specifically the policies and internal controls put in place to address possible risks associated with certain lending practices and transactions with financial institutions. Depository institutions were among the institutional investors that purchased loans from online marketplace lenders.

Please detail how your agency’s guidance related to third-party relationships applies to fintech companies, and what expectations your agency has for financial institutions that partner or otherwise engage with fintech companies. Please also describe: what factors your agency considers when determining whether and how to use its authority to examine and regulate third party service providers; steps you are taking to ensure financial institutions of all sizes understand the risks and benefits to partnering with or acquiring fintech companies, as well as regulatory expectations for fintech relationships with financial institutions; how often your agency has directly examined third-

⁸ 12 U.S.C. 1867. The banking agencies may also exercise general safety and soundness authority. Generally, “third-party relationships include activities that involve outsourced products and services, use of independent consultants, networking arrangements, merchant payment processing services, services provided by affiliates and subsidiaries, joint ventures, and other business arrangements where the bank has an ongoing relationship or may have responsibility for the associated records.” <http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html>.

⁹ Dodd-Frank Act, Section 1002, 1021-1024. Generally, the CFPB has authority to regulate consumer financial products or services offered by covered persons. Subject to some limitations, “covered persons” includes any person engaged in offering or providing a consumer financial product, and any affiliate if such affiliate acts as a service provider to such person. A service provider is defined as “any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer financial product or service.” Additionally, “a person that is a service provider shall be deemed to be a covered person to the extent that such person engages in the offering or provision of its own consumer financial product or service.”

¹⁰ OCC, 2013-29, Third-Party Relationships: Risk Management Guidance (Oct. 30, 2013), <http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-29.html>; FDIC, FIL-44-2008, Guidance for Managing Third-Party Risk (Jun. 6, 2008), <https://www.fdic.gov/news/news/financial/2008/fil08044.html> (“Financial institutions generally enter into third-party relationships by outsourcing certain operational functions to a third party or by using a third party to make products and services available that the institution does not originate. Also, financial institutions may enter into arrangements with third parties in which the institution funds certain products originated by a third party”); Federal Reserve, SR 13-19, Guidance on Managing Outsourcing Risk, <https://www.federalreserve.gov/bankinfo/reg/srletters/sr1319.htm>; NCUA, 07-CU-13, Evaluating Third Party Relationships, <https://www.ncua.gov/Resources/Documents/LCU2007-13.pdf>; CFPB, 2012-03, Service Providers, http://files.consumerfinance.gov/f/201204_cfpb_bulletin_service-providers.pdf.

party service providers that are fintech companies; and whether your agency has sufficient examination and enforcement authority over third-party service providers.

Consumer and Small Business Protections

If a fintech company is neither directly regulated by your agencies nor a third party service provider, there are concerns that applicable federal consumer laws may not extend to consumers engaging with fintech companies, and that consumers or small business owners may not understand that protections provided by federal financial institutions do not apply to the products and services offered by these companies.

Many fintech firms use alternative data and proprietary algorithms to underwrite loans. While these alternative approaches may provide the opportunity to expand access to credit, some observers have raised concerns about the potential for violations of fair lending laws as well consumer protection laws such as the Fair Credit Reporting Act.¹¹ Since many fintech companies do not have physical locations, providing the basis for a geographical assessment area, stakeholders have questioned how the regulators apply the Community Reinvestment Act (CRA) to alternative systems for delivering retail banking systems.¹² Others have raised concerns about the portability of data and consumer rights to access information held by private companies.

To the extent that some of these companies are offering products and services to small businesses instead of individuals, there may also be questions about the protections afforded to small businesses. The Treasury Department recently issued a white paper that noted “strong evidence indicates that small business loans under \$100,000 share common characteristics with consumer loans yet do not enjoy the same consumer protections.”¹³

As we noted in our letter to the Treasury Department and Small Business Administration last November, the Cleveland Federal Reserve Bank published a survey noting that many small business owners find it difficult to compare online small business loans due to lack of standardization of terms.¹⁴ Former SBA Administrator Mills has noted that “the current online marketplace for small business loans falls between the cracks for Federal regulators.”¹⁵

¹¹ See, e.g., Department of the Treasury, Opportunities and Challenges in Online Marketplace Lending (May 10, 2016) https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf.

¹² See, e.g., OCC, Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective (Mar. 2016).

¹³ Department of the Treasury, Opportunities and Challenges in Online Marketplace Lending (May 10, 2016) at 28 https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf.

¹⁴ Federal Reserve Bank of Cleveland, Alternative Lending through the Eyes of “Mom and Pop” Small-Business Owners: Findings from Online Focus Groups (Aug. 25, 2015), at <https://www.clevelandfed.org/en/Newsroom%20and%20Events/Publications/Special%20Reports/sr%2020150825%20a%20Alternative%20lending%20through%20the%20eyes%20of%20mom%20and%20pop%20small%20business%20owners.a%20spx>.

¹⁵ Karen Gordon Mills and Brayden McCarthy, The State of Small Business Lending: Credit Access during the Recovery and How Technology may Change the Game (Jul. 2014), at http://www.hbs.edu/faculty/Publication%20Files/15-004_09b1bf8b-eb2a-4e63-9c4e-0374f770856f.pdf.

The 2015 Small Business Credit Survey, published in March 2016, showed that 20% of small business firms applied for financing with an online lender, but were generally not very satisfied with their experience, citing concerns with interest rates and unfavorable repayment terms.¹⁶

Please provide a description of the direct and indirect authority that your agency has to supervise companies that make consumer and small business loans or advances; your views on alternative data to underwrite loans or advances, and the ability of your agency to enforce consumer protection and fair lending laws and ensure that fintech companies are CRA compliant; plans to implement section 1033 of the Dodd-Frank Act; and the Treasury Department's assessment regarding the loan characteristics of small business loans under \$100,000.

Coordination

Fintech, and the challenges and opportunities it presents, is a global phenomenon. Treasury recently recommended that an interagency working group be created to facilitate coordination on marketplace lending that would include CFPB, FDIC, FRB, FTC, OCC, SBA, SEC, a state bank supervisor representative, and Treasury.

International coordination may also be needed. The European Central Bank,¹⁷ Australia,¹⁸ World Economic Forum,¹⁹ and the World Bank²⁰ have recently published fintech papers that highlight opportunities and challenges for international regulators. While fintech may increase the availability of financial services across borders, there may also be complicated implications for international law. The UK has been active in fintech, including its regulatory sandbox,²¹ FinTech Innovation Lab London, and additional research.²² The UK Financial Conduct Authority recently created and began accepting applications for a "regulatory sandbox," which allows companies to "test innovative ideas without immediately incurring all the normal regulatory consequences."²³

In the United States, the Consumer Financial Protection Bureau formed Project Catalyst to engage with companies developing innovative consumer financial products and services and established a process for obtaining a no-action letter (NAL) concerning innovative financial products.²⁴

Please provide details on coordination between agencies and through interagency bodies, as well as international coordination, including effectiveness of your efforts to raise agency-specific concerns

¹⁶ Federal Reserve Banks of New York, Atlanta, Cleveland, Philadelphia, St. Louis, Boston, and Richmond, 2015 Small Business Credit Survey: Report on Employer Firms (Mar. 3, 2016), https://www.newyorkfed.org/newsevents/news/regional_outreach/2016/an160303.

¹⁷ Benoit Coeure, Member of the Executive Board of the European Central Bank, From Challenges to Opportunities: Rebooting the European Financial Sector (Mar. 2, 2016), <https://www.ecb.europa.eu/press/key/date/2016/html/sp160302.en.html>.

¹⁸ <http://fintech.treasury.gov.au/>.

¹⁹ http://www3.weforum.org/docs/WEF_The_future_of_financial_services.pdf.

²⁰ http://www.ifc.org/wps/wcm/connect/Industry_EXT_Content/IFC_External_Corporate_Site/TMT/Priorities_TMT/TMT_Fintech

²¹ <https://www.fca.org.uk/news/regulatory-sandbox>.

²² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/502995/UK_FinTech_-_On_the_cutting_edge_-_Full_Report.pdf.

²³ <https://www.fca.org.uk/news/innovate-finance-global-summit>.

²⁴ http://files.consumerfinance.gov/f/201602_cfpb_no-action-letter-policy.pdf.

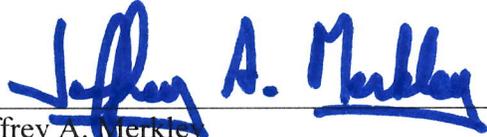
to other agencies or international bodies. Please also comment on how your agency balances a culture of fostering innovation with your agency's regulatory and supervisory responsibilities.

We appreciate the information you can provide on these important topics. These companies are changing financial services, and it is vital that the regulators and Congress understand all the impacts and take actions as appropriate. Please do not hesitate to contact Ms. Jeanette Quick, Senior Counsel of the Senate Banking Committee, at (202) 224-1569, or Ms. Lauren Oppenheimer, Minority Staff Director of the Subcommittee on Financial Institutions and Consumer Protection, at (202) 224-3753, if you have any questions.

Sincerely,



Sherrod Brown
United States Senator



Jeffrey A. Merkley
United States Senator