

Treasury Report Recommends More Consistent Regulation to Spur Innovation

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On July 31st, the Treasury Department (“[Treasury](#)”) released its fourth and final report in response to President Trump’s [Executive Order 13772](#). The report, entitled “A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation” (the “[Report](#)”), only briefly addresses distributed ledger technologies, blockchain and digital assets, but takes broad aim at perceived regulatory challenges to innovation. The Report argues for a significant rethinking of state and federal regulation across data access, licensing, payments and many other issues.¹

The recommendation that initially attracted the most media attention was Treasury’s endorsement of the special purpose national bank charters (“[FinTech Charters](#)”) proposed by the Office of the Comptroller of the Currency (“[OCC](#)”). Hours later, the OCC announced that it will accept applications for FinTech Charters from financial technology (“[FinTech](#)”) companies that offer bank products and services and meet the OCC’s chartering requirements (the “[FinTech Charter Policy Statement](#)”) and new Licensing Manual (the “[Comptroller’s Manual Supplement](#)” or the “[Supplement](#)”).² We will publish a follow-up Alert addressing the OCC’s FinTech Charter in greater detail in the coming days.

The Report, however, has a much broader focus. While Treasury makes recommendations across the spectrum of issues relevant to FinTech innovations, such as the regulation of products, services, marketplace lending and access to and use of consumer data, the report suggests far-reaching changes to the relationships between state and federal regulators and to regulatory frameworks for banks and other enterprises. Treasury notes that it incorporated “insights from the engagement process for the previous three reports” into this Report. As a result, the recommendations reflect a cumulative scope principally unified by the stated intent to spur innovation.

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Treasury Report: Key Takeaways

- **Ambitious Recommendations to Revamp Key Regulatory Frameworks.** Treasury’s findings and recommendations are organized into four thematic categories:

1. Embracing Digitization, Data, and Technology;
2. Aligning the Regulatory Framework to Promote Innovation;
3. Updating Activity-Specific Regulations; and
4. Enabling the Policy Environment.

The Report reflects a clear intent to examine how the current regulatory system – state and federal – affects innovation and market efficiency. The four thematic categories, taken together, include recommendations that span the broadest array of issues of the four Treasury reports responsive to Executive Order 13772. Within each category, the focus is consistently on how current regulations and the framework through which they are developed and applied could impede innovation and how they should be modified to spur greater efficiencies. This focus inevitably leads to recommendations that would provide more clarity in many areas, while promoting a more consistent national regulatory framework for many financial services. While Treasury recognizes that state regulation may make federal regulation unnecessary in some areas, such as payday lending, the Report clearly emphasizes the need for consistency over the state role.³ The Report clearly reflects industry concerns over the inconsistencies, opacities and ambiguities currently found in state, as well as federal, regulatory frameworks.

The Report does address specific consumer protection issues, particularly those involving data security and credit bureaus, but compared to the previous Administration’s regulatory emphasis on consumer rights and protections the Report focuses much more on an efficient market for

financial services as fundamental to consumer benefits.

- **The National FinTech Charter.** Treasury recommends that the OCC move forward with the proposed FinTech Charter, which was initially proposed in 2016. As noted above, the OCC quickly announced it would begin accepting new FinTech Charter applications. Treasury also suggests that the Board of Governors of the Federal Reserve System (“Federal Reserve”) consider whether these special purpose national banks should have access to the federal payment system. It remains to be seen whether companies that have sought industrial loan company charters will now, instead, pursue a FinTech Charter. We address the OCC FinTech Charter in more detail in a separate Alert memorandum.
- **Potential Realignment of State Oversight.** In the interest of creating more consistent regulatory frameworks, the recommendations in the chapter on “Aligning the Regulatory Framework to Promote Innovation” could significantly modify the relationship between state and federal oversight. The Report advocates harmonizing licensing and supervision requirements that govern non-bank financial services. Treasury focuses specifically on non-bank lending and money transmission, which are the regulatory issues today most affecting FinTech financial services firms. Potentially most significantly, the Report recommends that Congress intervene to encourage or impose greater uniformity if the states are unable to achieve more consistency.
- **Efforts to Modernize Federal Banking Regulations and Guidance.** The Report points out the variations and inconsistencies in federal regulation of similar or identical activities. In a number of areas, Treasury recommends steps by federal regulators to create clearer and more harmonized standards.

In particular, Treasury notes that the current application of the bank holding company “control” definition is highly discretionary and difficult to

ascertain. The Report recommends that the Federal Reserve and other banking regulators reassess the definition of “control” to provide simpler and clearer standards in order to allow investors to better assess the implications of their investments.

Additionally, the Report encourages the Federal Reserve, the Federal Deposit Insurance Corporation (“FDIC”) and the OCC to coordinate, through the notice and comment process, a review of guidance on the risks posed by third-party relationships. Treasury suggests that this review should aim to ensure the guidance is actually applied in a risk-focused manner so that banks can more effectively engage with third-parties and thereby facilitate innovation. Treasury particularly emphasizes the value of partnerships with FinTech lenders and other innovative companies.

Treasury also recommends that federal agencies modernize their requirements and guidance to enable the adoption of new technologies, such as cloud computing, in order to remove unnecessary barriers to migrating activities to modern systems. Coupled with the Report’s recommendation that the Securities and Exchange Commission (“SEC”) address outdated recordkeeping rules, such as SEC Rule 17a-4, these proposals would, if implemented, have an impact on other emerging applications, such as distributed ledger technologies.

- **Treasury Proposes Several Steps to Make Regulations More Flexible and Recommends Creation of Regulatory “Sandboxes”.**

Borrowing from the concept popularized by the Financial Conduct Authority in the United Kingdom and building on lessons from the Commodity Futures Trading Commission’s (“CFTC”) LabCFTC initiative, Treasury recommends that state and federal regulators work with self-regulatory organizations to coordinate and expedite regulatory relief under applicable laws and regulations to permit meaningful experimentation for innovative products, services and processes in the form of a “regulatory

sandbox.” Should these agencies and organizations prove unable to achieve the Report’s stated objectives, Treasury recommends that Congress consider legislation to create a single process, preempting state laws if necessary.

The Report also contains recommendations for reshaping the regulatory apparatuses of federal and state agencies. Treasury proposes that Congress enact legislation authorizing federal regulatory agencies to research and develop, in consultation with the private sector, applications of technology to supervisory and regulatory activities in order to promote effective and efficient regulation.

- **Use and Abuse of Consumer Data.** The Report extensively discusses the changes in the marketplace in the acquisition and use of consumer data. These issues involve consumer access to financial information, data aggregation, disclosures when data is accessed and used and the ability of consumers to revoke prior authorizations to use their data. Among other suggestions, Treasury recommends that the Consumer Financial Protection Bureau (“CFPB”) clarify the definition of “consumer” in the context of data access requests from authorized third-parties and further proposes that the CFPB work with the private sector to develop best practices on disclosures and terms and conditions regarding consumers’ use of products and services.
- Treasury also addresses the recurring issue of data breaches and recommends that Congress enact a federal data security and breach notification law to protect consumer financial data and notify consumers of a breach in a timely manner.
- **State Regulatory Authorities Express Strong Opposition to Treasury’s Proposals and the OCC’s FinTech Charter.** The New York State Department of Financial Services (“NYDFS”) quickly [released a statement](#) opposing Treasury’s “regulatory sandbox” initiative and the OCC’s FinTech Charter, which John W. Ryan, the President of the Conference of State Bank

Supervisors (“CSBS”), later called “a regulatory train wreck in the making.”

Overview and Comments on the Report

Chapter I: Embracing Digitization, Data & Technology

Digitization

- Treasury discusses the growing reliance in the economy on “digital communications,” such as smartphones, social media and other communication forms. Treasury notes that many existing laws have not kept pace with changes in the communications’ environment.
- An example is the Telephone Consumer Protection Act (“TCPA”) governing telemarketers. Treasury recommends that the Federal Communications Commission (“FCC”) provide guidance on reasonable methods for consumers to revoke consent under the TCPA. Treasury further recommends that Congress consider statutory changes to the TCPA to mitigate unwanted calls and provide a revocation standard similar to the Fair Debt Collection Practices Act (“FDCPA”).
- Treasury also recommends that the CFPB promulgate regulations under the FDCPA to codify that reasonable digital communications, particularly when they reflect a consumer’s preferred method, are appropriate for use in debt collection.

Consumer Financial Data

- The Report provides both an overview of data aggregation issues and notes the conflicting questions posed by acquisition and use of consumer data, the divergent interests of different holders of consumer information and the benefits and risks of data aggregation.
- Treasury notes that there is only one specific federal statutory provision regarding access to a consumer’s own financial account and transaction data (Section 1033 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-

Frank”). While that provision requires certain companies to make available to a consumer, upon request, certain financial account and transaction data, the CFPB has not clarified whether third parties properly authorized by consumers, including data aggregators and consumer FinTech application providers, may access such data as the “consumer.” Treasury recommends that the CFPB allow such access. The Report also recommends that Congress take no further legislative action to expand Section 1033’s scope.

- The Report recommends that regulators, including the SEC, Financial Industry Regulatory Authority (“FINRA”), U.S. Department of Labor and state insurance regulators, consider whether further measures are needed to facilitate consumer access to financial account and transaction data in electronic form. Relatedly, the day before the Report’s publication, FINRA published a special notice (the “FINRA FinTech Notice”) requesting comments on how to help broker-dealers and investors address issues raised by data aggregation, among other matters.⁴
- Treasury also recommends that the CFPB work with the private sector to develop best practices on disclosures and the terms and conditions governing consumers’ use of products and services powered by such data. The Report suggests that this should include new principles-based disclosure rules, if necessary, while noting that many current disclosures are hard to follow, at best. Another important part of the process is how consumers may revoke their prior authorizations permitting access to their financial accounts and transaction data. While the Report does not go into detail on any recommendations on this issue, it does suggest broadly that data aggregators and FinTech applications providers offer adequate means for consumers to readily revoke their prior authorizations. This proposal may necessitate banking regulators and the SEC to issue rules requiring financial services companies to comply with consumer requests to limit, suspend or terminate access to such data.

- Treasury believes the private sector, with appropriate involvement by Congress and financial regulators, as necessary, should work to remove legal and regulatory uncertainties holding back financial services companies and data aggregators from establishing data sharing agreements that address data sharing, security, liability for data access and standardization of data elements, in a way that also mitigates implementation costs for financial institutions with more limited resources.
- Similarly to certain other recommendations, Treasury asserts that any additional regulation of data aggregation should occur at the federal level by regulators that have significant experience in data security and privacy and that will have, through legislation if necessary, broad jurisdiction to ensure equivalent treatment in the nonfinancial sector. At the federal level, Treasury recommends that banking regulators remove ambiguity stemming from the third-party guidance that discourages banks from moving to more secure methods of data access, such as Application Programming Interfaces.
- Treasury further recommends that Congress should enact a federal data security and breach notification law – preempting state laws – to protect consumer financial data and notify consumers of a breach in a timely manner. Such a law should include standards that are technology-neutral and scalable based on the size of an entity and the type of activity in which the entity engages and should reflect existing federal data security requirements for financial institutions.
- Another issue of importance addressed by the Report is digital legal identity products and services. As noted in the Report, such digital identity developments are important to improve efficiencies, reduce losses and enhance consumer services. Treasury recommends that the financial regulators work with Treasury to enhance public-private partnerships to identify ways the government can facilitate the adoption of trustworthy digital legal identity products and

services, while eliminating unintended or unnecessary barriers.

- Treasury also supports the Office of Management and Budget’s efforts to implement a federated digital identity system.

The Potential of Scale

- Treasury recommends that federal financial regulators modernize their requirements and guidance to reduce unnecessary barriers to new technologies, particularly with respect to cloud computing, by:
 - formally recognizing independent U.S. audit and security standards that sufficiently meet regulatory expectations;
 - addressing outdated recordkeeping rules, such as broker-dealer recordkeeping requirements in SEC Rule 17a-4;
 - clarifying audit requirements;
 - setting clear and appropriately tailored chain outsourcing expectations; and
 - providing staff examiners appropriate training to implement agency policy.
- Treasury recommends that the financial regulators establish a cloud and financial services working group to engage key stakeholders promoting the use of cloud technology within the existing U.S. regulatory framework and to seek supervisory or appropriate technological solutions to data security, privacy, availability and access issues.
- With respect to artificial intelligence, Treasury cautions against regulatory burdens that could hamper implementation of artificial intelligence and machine learning. Instead, Treasury recommends that regulators clarify existing standards and engage the Select Committee on Artificial Intelligence to coordinate interagency efforts related to artificial intelligence applications.

The FINRA FinTech Notice also focuses on artificial intelligence, but from a more circumspect perspective, with a focus on appropriate

governance, quality assurance and supervisory practices.

Chapter II: Aligning the Regulatory Framework to Promote Innovation

Modernizing Regulatory Frameworks for National Activities: Improving the Clarity and Efficiency of Our Regulatory Frameworks

- The Report effectively recommends a national standard for licensing and supervision of FinTech companies. Treasury encourages the states to build a unified licensing regime and supervisory process, which could include the adoption of model banking laws or a passporting regime for licensure. However, if the states are unable to achieve this goal within three years – which will be a challenge – the Report advocates Congressional intervention to “encourage greater uniformity” by setting standards to be adopted, supervised and enforced by the state regulators.
- It is in this context that Treasury recommends for the OCC to pursue issuing FinTech Charters. The Report notes that the OCC has the authority, and in fact, the OCC has issued national trust bank charters in the past without requiring deposit insurance.
- Treasury recommends that the Federal Reserve, the FDIC and the OCC coordinate a review of guidance for the regulatory oversight of banking organizations’ relationships with third parties, such as vendors and service providers. Treasury recommends that these agencies, utilizing the notice and comment process, improve current tailoring and the scope of the application of guidance for relationships with third-party vendors to improve the efficiency of oversight, while also enabling banking organizations to develop safe and prudent relationships with innovative third-party product and service providers.
- The Report also proposes that the Federal Reserve, the FDIC and the OCC coordinate to harmonize their interpretations of banking organizations’ permitted scope of activities to promote the

adoption of technology that can positively affect the delivery of financial services.

Chapter III: Updating Activity-Specific Regulations

Lending and Servicing

- The Report provides an overview of marketplace lending and the opportunities and challenges of the growing role it plays in the loan market. Not unlike gaps that affected non-bank mortgage originators prior to the financial crisis, there are regulatory gaps and inconsistencies for marketplace lenders and for those banks that partner with them. The Report notes that “appropriately defined lending partnerships” can leverage the advantages from the innovations in marketplace lending and the stability and experience of banks. However, recent case law presents legal issues for these partnerships.
- A principal legal issue is presented by the Second Circuit’s decision in *Madden v. Midland Funding, LLC*,⁵ which held that the National Bank Act did not preempt state usury laws for loans purchased by a third-party debt collector from a national bank. *Madden* has created significant problems in the secondary market for loans, which had been generally viewed as enforceable by subsequent purchasers if “valid when made” by the original lender. Treasury recommends that Congress codify the “valid when made” doctrine to preserve the functioning of U.S. credit markets.
- A related issue in the credit markets is the uncertainty created by recent cases questioning whether a bank or a bank partner in lending transactions is the “true lender.” Premised generally on analyzing which partner has the “predominant economic interest” in the loan, these cases make structuring relationships with third parties challenging for banks and impede the ability to improve efficiencies. Treasury recommends that Congress codify the understanding that the existence of a service or economic relationship between a bank and a third

party, including FinTech companies, does not affect the role of the bank as the true lender of loans it makes.

- Treasury also makes a number of recommendations designed to streamline the lending and servicing of loans. For example, it proposes that Congress revisit the Title XI Financial Institutions Reform, Recovery and Enforcement Act (“FIRREA”) appraisal requirements to account for developments that have occurred in the market, such as the development of automated and hybrid appraisal practices. This recommendation seeks to apply technological developments in property-specific valuation methods more broadly to facilitate lending. Similarly, Treasury proposes that government loan programs, including the Federal Housing Administration (“FHA”), also explore opportunities to leverage industry-leading technology capabilities to reduce taxpayer costs and accelerate the adoption of new technologies in the government-insured sector.
- The Report also recommends that Ginnie Mae pursue acceptance of eNotes and develop greater digital capabilities, as set forth in the *Ginnie Mae 2020* roadmap. The Federal Home Loan Banks should likewise explore ways to address their concerns regarding eNotes with the goal of accepting eNotes on collateral pledged to secure advances.
- Treasury recommends that the FHA, Veterans Administration and U.S. Department of Agriculture explore both the development of shared technology platforms, including for certain origination and servicing activities, and the imposition of guaranty and insurance fee surcharges to account for added costs in states where foreclosure timelines significantly exceed the national average.
- Treasury recommends that the U.S. Department of Housing and Urban Development establish more transparent standards in determining which program requirements and violations it considers to be material with respect to mortgage loans insured by the federal government and continue to review FHA servicing practices with the intention of increasing certainty.
- With respect to Ginnie Mae’s mortgage lending and servicing, Treasury recommends aligning standard, detailed reporting requirements on nonbank counterparty financial health with those of the Federal Housing Finance Agency, the government-sponsored enterprises and the CSBS, in order to enhance its counterparty risk mitigation approach, charge appropriate guaranty fees and comprehensively assess its current staffing and contracting policies.
- With respect to lending and servicing by the Department of Education, Treasury recommends:
 - requiring student loan servicers to make greater use of emails in the Direct Loan Servicing contract;
 - contracting with providers of secure e-signature software and cloud technology for use by federal student loan servicers; and
 - implementing a risk-sharing program for institutions participating in the federal student loan program based on the amount of principal repaid following five years of payments.
- Inconsistent state and federal standards and industry practices in loan servicing, as well as loss mitigation, were significant issues during the financial crisis. The Report notes the progress of improved standardization in successful crisis-era programs and recommends that federal mortgage program agencies explore further standardizing effective mitigation programs.
- However, the related issue of divergent state foreclosure requirements and standards still remains. While motivated by consumer protection and, sometimes, efficient market considerations, the inconsistencies in state foreclosure standards have been a major challenge to a more efficient,

less costly national mortgage market. Treasury recommends long-considered reforms that have had limited effectiveness thus far, including harmonization of state laws through model foreclosure laws and federal program surcharges to reflect the additional costs imposed by states with longer foreclosure timelines.

- With respect to credit bureaus, Treasury encourages Congress to amend the Credit Repair Organization Act to exclude national credit bureaus and national credit scores from the definition of “credit repair organization.”

Payments

- Treasury proposes that the CFPB modify Regulation E by providing increased flexibility regarding the issuance of Regulation E disclosures and raising the existing 100 transfer per annum threshold for applicability of the *de minimis* exemption.
- The Report recommends that the Federal Reserve should work to increase the speed of payments by setting public goals and deadlines consistent with the conclusions of the Faster Payments Task Force’s final report and facilitating a faster retail payments system, such as through the development of a real-time settlement service. Any such a retail payments system should also be available to smaller financial institutions with more limited resources, such as community banks and credit unions.
- Treasury also recommends the development of an actionable plan to improve security in the U.S. payments system. Given the rapid pace of innovation, such a plan should not include specific technology mandates.

Chapter IV: Enabling the Policy Environment

International Approaches and Consideration

- Treasury believes it is premature to develop international regulatory standards for many applications of financial technology. However, Treasury recommends that relevant experts should

continue to participate in international forums and standard-setting bodies.

- The Report recommends that Treasury and U.S. financial regulators engage proactively with international organizations to ensure that such organizations are adhering to their core mandates and taking actions aligned with U.S. national interests and the domestic priorities of U.S. regulatory authorities.
- The Report also states that Treasury and U.S. financial regulators should engage with the private sector with respect to international bodies’ programs dealing with financial technology to ensure appropriate regulatory approaches.

More Agile Regulation

- Treasury emphasizes throughout the Report the importance of regulatory engagement with the private sector. Consistent with many recommendations in the past, which were only unevenly followed, Treasury appropriately recommends that federal regulators meet with stakeholders outside of Washington, D.C. and develop partnerships with financial services companies and regulatory technology firms to better understand new technologies that can improve the execution of regulators’ responsibilities. Treasury also proposes ways for federal and state regulators, along with self-regulatory agencies, to cultivate relationships with industry participants, consumers and start-ups. As part of this outreach, Treasury encourages international initiatives and global engagement to promote knowledge of FinTech developments around the world.
- Treasury also encourages regulatory agencies to appropriately tailor regulations and to periodically review existing regulations as innovation occurs to allow regulated companies to continue to drive technological efficiency and cost reductions, while ensuring that such regulations fulfill their original purpose in the least costly manner.

- The Report recommends that federal, state and self-regulatory agencies and working groups thoroughly consider the cybersecurity and other operational risks posed by new technologies. Accordingly, the Report recommends that the Financial and Banking Information Infrastructure

Committee establish a working group to study and monitor new products and services and the risks that accompany such technological innovation.

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¹ THE DEPARTMENT OF THE TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES NONBANK FINANCIALS, FINTECH, AND INNOVATION (July 31, 2018), available at <https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf>.

² OFFICE OF THE COMPTROLLER OF THE CURRENCY, POLICY STATEMENT ON FINANCIAL TECHNOLOGY COMPANIES' ELIGIBILITY TO APPLY FOR NATIONAL BANK CHARTERS (July 31, 2018), available at <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/pub-other-occ-policy-statement-fintech.pdf>; OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S LICENSING MANUAL SUPPLEMENT: CONSIDERING CHARTER APPLICATIONS FROM FINANCIAL TECHNOLOGY COMPANIES (JULY 2018), at <https://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-considering-charter-applications-fintech.pdf>.

³ Report at 129.

⁴ See FINRA, Special Notice: Financial Technology Innovation (July 30, 2018), available at <http://www.finra.org/industry/special-notice-073018>.

⁵ See 12 U.S.C. § 85; Madden v. Midland Funding, LLC, 786 F.3d 246, 250-253 (2d Cir. 2015), cert. denied, 136 S. Ct. 2505 (2016).