U.S. consumer financial bureau asserting role as lead regulator of Fintechs

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The Consumer Financial Protection Bureau is positioning itself to be the U.S. regulator of fintechs as the sector expands into services traditionally offered by banks.

The CFPB has quietly rolled out a series of significant rule updates and guidance documents to cover consumer financial services outside traditional banks. The agency's actions aimed at digital upstarts have met a wave of criticism, along with some surprising support from the banking industry.

Since the CFPB's inception more than a decade ago under the Dodd-Frank Act, banks have repeatedly challenged the CFPB's legal authority and lobbied lawmakers to curb the agency, whose structure and funding mechanism help shield it from political pressure. But in its expansion into fintech and non-bank oversight, the consumer banking agency has found allies among mainstream banks who have long argued that the lightly-regulated new entrants into consumer finance pose unfair competition.

Policy makers, meanwhile, have raised concerns about the lack of a uniform regulatory structure to cover emerging fintechs. The CFPB, under the expansive vision of Biden-administration appointee Director Rohit Chopra, has shown a willingness to step into that role.

CFPB footprint gets larger and larger

"The CFPB's regulatory reach keeps getting larger and larger," said Alan Kaplinsky, senior counsel of Ballard Spahr LLP who has covered CFPB since its inception. "They keep pushing the envelope so far it seems there's virtually nobody they think they can't regulate."

The agency has done so "behind the scenes in a way that hasn't drawn a lot of notice," and with little or no formal rulemaking, Kaplinsky said. The CFPB's recently issued semi-annual rulemaking agenda included just four items, he added. But the agency has used a variety of tools to regulate the practices of banks, nonbanks and fintechs with interpretative rulings, consumer financial protection "circulars," advisory opinions, targeted studies, compliance manual updates, rulings relying on "dormant authority" and with orders for firms to produce information on specific areas of concern.

While banks have expressed discomfort with the agency's power, the initiatives to regulate new sectors of finance have generated significant support from the industry. Non-banks, facing fewer regulatory constraints, grew rapidly in the aftermath of the 2008 financial crisis as they transformed into digital-first operations. Their market share grew to as high as 70% of mortgage loans during the COVID-pandemic real estate boom.

Fintech study finds widespread adoption

Commercial banks are looking beyond mortgages to other emerging competitive threats from fintech. A report commissioned by a leading fintech, Plaid, "The Fintech Effect", said more than 88 percent of Americans regularly use fintech products. Fintech services include loans, financial planning, savings, investing and payments.

Although the banking industry remains wary of Chopra's regulatory agenda in areas such as enforcement of discriminatory lending, excessive fees and other consumer abuses, it has applauded CFPB's expanded fintech oversight. In the regulatory rollout the CFPB has taken on companies with trillions of dollars in market capitalization and more resources than traditional consumer financial services firms. Some of the main initiatives and updates showing how CFPB has expanded its oversight are:

Examining non-banks with the same standard as commercial banks. "Given the rapid growth of consumer offerings by non-banks, the CFPB is now utilizing a dormant authority to hold non-banks to the same standards that banks are held to," the CFPB said in an interpretive ruling. For many banks the leveling of the playing field may be too late. Wells Fargo & Co, Bank of America and JP Morgan Chase, the only banks among the top 10 mortgage lenders, have already signaled they will pull back. The CFPB's stated goal of examining non-banks marked one of the most significant expansions of its regulatory agenda. The agency also began examining banks for compliance with fair lending laws and Equal Credit Opportunity Act compliance.

Extending protections over data use in targeting consumer financial products. The CFPB in August issued an interpretive rule laying out when digital marketing providers for financial firms must comply with federal consumer financial protections over the use of data in activities such as recruiting customers. The data aggregation market is increasing at 50% a year, and is now estimated at $4 billion, with credit-related data the largest category, according to Grand View Research. In a petition to the CFPB eight banking industry groups -- the American Bankers Association, Consumer

Bankers Association, Credit Union National Association, Housing Policy Council, Independent Community Bankers of America, National Association of Federally-Insured Credit Unions, National Bankers Association, and The Clearing House Association -- asked the agency to consider "rulemaking that will strengthen the privacy and security of consumer financial data held by fintechs, Big Tech and data aggregators."

Holding lenders accountable for algorithmic models used in lending decisions. The CFPB issued a circular saying firms including fintechs that use algorithms in credit decisions must comply with "adverse notice" provisions of the Equal Credit Opportunity Act. The act mandates that lenders explain to consumers reasons for rejecting applications. The CFPB said that even if artificial intelligence processes behind such decisions may obscure the precise reasoning, that does not absolve the firm of the obligation to explain adverse decisions. Banks are heavy users of algorithmic processes but have generally supported rules that eliminate inconsistencies between regulated and unregulated lenders and confer an advantage on fintechs.

Probing buy-now pay-later practices. The CFPB has launched an initiative to examine fintech firms that extend credit to online consumers. The inquiry was aimed at Affirm, Afterpay, Klarna, PayPal, and Zip, the largest firms that allow consumers who purchase goods from thousands of retail sites to pay for their purchases over four installments. The short payback period has exempted the pay-later firms from credit lending rules for longer-term credit offerings. But the CFPB has said it is "concerned about accumulating debt, regulatory arbitrage, and data harvesting in a consumer credit market already quickly changing with technology." Banks have viewed the unregulated competition in consumer lending with growing alarm as new competition for their credit-card businesses, and some have either partnered with buy-now-pay-later firms or made tentative steps to offer similar products.

Reviewing employer-driven debt for potential abuses. Fintechs have set up programs with employers to extended loans to employees and collect repayments from paychecks. The agency is reviewing the extent of the practice and of "pricing, and other terms of the obligations, disclosures, dispute resolution, and the servicing and collection of these debts."

Looking for abuses in "embedded" payment systems. The CFPB has undertaken a broad review of payment systems used by services such as "unattended retail stores, parking lots, fuel pumps kiosks in quick service restaurants," and automated bill payments. The services "may make it easier for a consumer to be defrauded by an illegitimate merchant or unintentionally commit to a subscription that results in ongoing payments," CFPB said.

Sweeping review of Big Tech entry into financial services. In one of the first and most ambitious actions taken by the CFPB when Chopra assumed command last September, the agency launched a probe of financial services offered by some of the world's largest tech companies. The agency will produce a report in the near future on its findings that could recommend regulatory actions to address practices seen causing consumer harm. The agency launched its review with orders requiring information from Amazon, Apple, Facebook, Google, PayPal, and Square, and an additional study of payment system practices of Chinese tech giants, including Alipay and WeChat Pay. It will examine data harvesting and monetization, anti-competitive practices that restrict access to financial services, and consumer protections.

Anywhere financial services are offered

Even with support for banks for some of the moves, the CFPB's active regulatory agenda has drawn criticism from business interests and Republican lawmakers. The U.S. Chamber of Commerce charged that Chopra's fintech moves could "radically change the nature of America's financial services industry" and reduce innovation that will limit consumer choices.

Defenders say CFPB's expansion into fintech reflects its Dodd-Frank mandate to protect consumers "whenever and wherever they might come into contact with financial services and products," said Mark Hays, senior policy analyst at consumer advocacy group Americans for Financial Reform.

The agency's fintech moves are necessary to limit abuse from misleading consumers by "presenting their wares as one type of financial product while generating profits through exploiting regulatory gaps in another industry space." The CFPB is "well-suited to address this pattern," Hays said.

Stepping across the regulatory perimeter

Other regulators have failed to keep up with the fintech transformation and need to recognize the "need to step in when fintech products cross the regulatory perimeter," he added.

Kaplinsky, who often represents banks in CFPB related matters, acknowledged a need for regulators to address the risk of hidden technology abuses, but criticized Chopra's process of pushing ahead with significant rule changes without going through a process of posting rules and soliciting comments. He also expressed doubts that the agency will be able to add enough staff and expertise to fill out its expanded role as the go-to fintech regulator. The CFPB, for its part, has made clear it needs to hire more fintech specialists but has also partnered with state and federal to create efficiencies.

Despite staffing concerns, there are signs that enforcement actions will emerge soon from the agency's deep dive into fintech practices, he added. "There have been relatively few actions so far, but there are numerous CFPB inquiries underway, and we should see a lot more actions soon." The agency will almost certainly face pushback in the form of lawsuits challenging the enforcement of new rules arising from the fintech initiatives' fast-tracking by the agency without sufficient industry input, he said.

The Congressional Research Service in a report issued in late July saw the need for regulators to act on the rapidly expansion of finance by leading tech firms. Their "expansion into certain areas arguably tests the limits of existing regulatory structures that were not designed with Big Techs in mind. They may decide to expand their footprint in existing services and to grow in a manner that mirrors nonbank financial companies. Alternatively, they may opt to offer more bank-like activities."

"Some observers question whether the existing regulatory framework is adequate." the CRS report said. "Regulation-related policy issues include, as well, consumer protection concerns and evolving data security and privacy laws. Other policy issues include financial inclusion, algorithmic bias, and third-party and cyber risk. How these companies evolve will have consequences for many of these policy issues but perhaps none more so than the companies' regulatory treatment."

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