Our Perspectives:
Commentary on the economy & regulatory policies affecting financial companies

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The Coming Clash Between Financial Technology and Financial Regulators[*] [†]

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One of the many casualties of the financial crisis was consumer trust in the financial services industry. A growing number of technology companies are angling to fill this void. Companies like Billfloat are offering credit products. Prosper is offering to link borrowers and savers through crowd funded personal loans. Simple is providing debit cards, and helping consumer track spending and set savings goals. None of these companies are banks, nor are they subject to bank-like regulation. However, the regulatory clouds are gathering.

The Consumer Financial Protection Bureau, which was created in the Dodd-Frank Act, has strong regulatory powers over all firms that provide financial products and services to consumers. To date, that agency has been consumed with direct legislative mandates from Dodd-Frank, such as underwriting standards on mortgages and the provision of remittances. Yet, it is inevitable and wise that the CFPB focus attention on technology firms that are increasingly offering credit, advisory, and other financial products and services to consumers. The CFPB has the power to supervise and regulate any firm that is "providing payments or other financial data processing products or servicing to a consumer by any technological means." The CFPB also can examine technology companies that provide material services to traditional banks, including processing services.

At this juncture, it is too early to know how the CFPB, or any of the various other federal financial regulators, may exercise authority in this space. Yet, there is no lack of potential regulatory hooks, including the Truth-in-Lending Act and the Electronic Funds Transfer Act. It is clear, however, that

[*] The information contained in this newsletter does not constitute legal advice. This newsletter is intended for educational and informational purposes only.

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the two worlds will collide. Regulators regulate, and when they do act, it can have dramatic impact on a company's business model. Just ask the founders of Bitcoin about the potential impact of anti-money laundering rules on their network. Or ask the innovative taxi app Uber, which is threatening to leave the Washington, D.C. market because new payment systems regulations by the local taxi commission are incompatible with the firm's app-based service.

The coming clash can have a positive side. New regulations can open new business opportunities for firms. One of us was actively engaged in the development and passage of the Check 21 Act of 2003. That Act brought the century-old backroom process of check clearing into the digital age. Every time a consumer deposits a check electronically at an ATM or by taking a picture with their smart phone, they can thank the Check 21 Act for making that possible. A decade after passage, banks are now competing to provide the best app to allow consumers to deposit checks from their living room. Technology companies are frequently providing the power behind the app. Moreover, CFPB already has shown interest in promoting new technologies that expand the range of financial products and services for consumers.[1] The Treasury Department recently sponsored a competition for innovative applications to "enhance consumer financial capability and decision-making." The government is clearly trying to promote new technology to provide consumers additional opportunities to access financial services and make more informed financial choices.

The challenge for technology companies that are active in the financial services sector is to turn this inevitable clash into a business opportunity, a la Check 21, and not one that drowns out innovative ideas under the weight of laws and regulations designed for different times and different types of firms. The stakes are high and will affect you in many different ways, not only when you deposit a check, but when you try to hail a cab.

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[1] See ***Project Catalyst.***