The Consumer Finance Podcast: 2023 Year in Review and a Look Ahead Series: FinTech Developments
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Guests: James Kim
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Chris Willis:

Welcome to *The Consumer Finance Podcast*. I'm Chris Willis, the co-leader of Troutman Pepper's Consumer Financial Services Regulatory Practice. And today's episode is going to be another installment in our Year in Review and a Look Ahead series, this time specifically talking about fintech, which I know will be of interest to all of you.

But before we jump into that topic, let me remind you to visit and subscribe to our blogs. TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And don't forget about our other podcasts. We have the *FCRA Focus*; all about credit reporting. *The Crypto Exchange*; about all things crypto. *Unauthorized Access*; which is our privacy and data security podcast. And, finally, *Payments Pros*; all about the payments industry. All those podcasts are available on all popular podcast platforms.

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Now, as I said today, we're going to be talking about important events that happened in 2023 and a look ahead to 2024 in the fintech world. And joining me to talk about that today is my partner, James Kim, who heads up our fintech practice. James, welcome to the podcast. And thanks for being here today.

James Kim:

Thanks, Chris. I'm very excited to talk about what's important to me and I think for many of our clients.

Chris Willis:

Yeah. let's talk through some of the key regulatory developments that sort of occurred in 2023 that you think may continue to impact the industry in the coming year. Can you tell the audience about some of those?

James Kim:

Sure. I mean, there are a lot. But we're going to focus on a few of the key ones today. The two that jumped out immediately, because they happened toward the end of 2023, are two potentially monumental proposed rules issued by the Consumer Financial Protection Bureau.

The first was in October of 2023, was the highly anticipated notice of proposed rulemaking for open banking under Section 1033 of the Dodd-Frank Act. And that proposed rule would basically empower consumers to have greater access and control over their financial data. And it would require banks and non-banks both to make available to consumers and to third parties authorized by consumers to have access to certain data about the consumer's accounts and other information that the covered institutions would possess, right? And it would create certain ground rules for providing access to the data, I think data security, around storing it sharing that data.

But I call it monumental because this is, one, a long time coming. And two, it would impact nearly everybody. This is applicable to banks and non-banks. There are very narrow exceptions for small community banks and credit unions. But otherwise, this would be a large obligation I think imposed on everybody. Because, nowadays, accessing data is very commonplace and I think very important.

In other words, it's very typical for me, let's say if I'm applying for a loan, to give the lender access to my bank account information to help apply for the loan and help underwrite. That's one example or one use case I think applicable to the proposed rule. That's one.

And then the second one, within a few weeks, the Bureau published this other big rule. In early November they proposed a rule to define larger market participants for the digital payments space. This is because it's a larger participants rule. Really, the purpose of the rule is to define the market, which is digital payment applications general use. Digital payment applications. And then a 5 million transaction threshold. And if you're above that 5 million, you would be considered a larger participant. And the consequence of being a larger participant in that so-called market would be being subject to CFPB supervision, which is a whole different level of regulation. Meaning you just don't have to comply with whatever the various laws are. You are actually subject to supervision like a bank. Those are the two big ones.

And looking ahead to 2024, I think everybody – and I'd love to get your thoughts on this Chris, the expectation is the director, Mr. Chopra, will issue – take the next step in the rulemaking by the end of this year because of the presidential election. And I think there's a lot of motivation by Director Chopra and the Bureau to kind of push these rules through before a potential change in administration.

Chris Willis:

Yeah. I definitely agree with that. There's also the potential overlay of trying to get them through before the Congressional Review Act window closes. I kind of doubt that these two will be done before that time. Because that time runs roughly in April of 2024. And I think it's too soon probably for both of these. But I agree with you that there'll be a high motivation to get them finalized before the election occurs in November 2024. And also agree with you that they're both monumental. Because one of them will bring about a complete change in the way customer data is handled by all kinds of lenders for all kinds of products and impose significant new obligations on the providers of those products. And the other one will take a whole swath of the market that the CFPB has attempted to put its hands on and subject them to CFPB supervision of every detail of the inner workings of their business. And we know from our own experience that supervision is the gateway for the CFPB to apply significant pressure to an industry. Much more so than they can through simple enforcement investigations at least is my view on it.

James Kim:

Yeah. No. I agree. And just to – I was remiss in not really talking about the import of the larger participant rule for digital payments. Let's touch upon that for a second.

First, our team here at Troutman Pepper, I'm very proud of the fact that we were engaged by two major trade associations, the Financial Technology Association, FTA, and TechNet to submit their comment letter. I encourage everybody to look at the public comments. There are only about 60 for the larger participant rule and two of them were with a lot of drafting, and support and help from Troutman Pepper. I want to just call that out.

But in my view – and these are my words, right? These are my personal views. That there is no such thing as a general-use digital payments application market. It doesn't exist. There's no such thing as a general-use consumer credit market, right? I mean, that's kind of an absurd notion for decades, a century, right? Consumer credit is defined into distinct markets. Small-dollar, mortgage, auto, student, open and closed. You name it.

It's very puzzling for the CFPB to just create this, like I said, non-existent arbitrary general-use digital payments market that conflates things that are wildly different. Pass-through digital wallets, payment functionality, holding digital assets in crypto. It's like a mishmash. And, really in my view, it's kind of a gerrymandered definition to basically make sure that the Bureau can capture and supervise large tech companies. Because they all offer some form of payment functionality one way or another. And that's the holy grail for a lot of agencies, but the CFPB in particular, to go after big tech. Because there is no comprehensive federal supervisory scheme for tech companies.

I think that's the end objective for the Bureau. And you're familiar with this. In my view, the model or precedent that I think the CFPB is seeking to follow is, when Dodd-Frank was enacted and the Bureau became live or operational in 2011, the first thing they wanted to do on the supervisory front was to supervise the big three credit reporting agencies.

Because, again, they were subject to various regulations and statutes. FCRA in particular. But they had never been supervised in any comprehensive way. They were chomping at the bit. As soon as the operational day in 2011, July 2011 in effect, they immediately started supervising and getting underneath the hood of the big CRAs. And they've never left essentially. I think a similar playbook is probably what they have in mind for the tech companies.

Chris Willis:

Well, and really, James, first of all, I totally agree with you. But it kind of makes you wonder why it took the director so long. Because it was sort of evident from the first week after he was appointed as director that this was a priority for him because of the issuance of those 1022 orders to the big tech companies that I think happened within about a week of him taking office. And so, it was evident that was something of interest to him. It kind of makes me wonder why the larger participant rule took so long.

James Kim:

Yeah. I mean, good point. I mean, I would say that Director Chopra's interest in big tech companies was clearly signaled from before his days at the CFPB when he was a commissioner at the Federal Trade Commission. Our comment letters I think clearly indicate deficiencies in the rulemaking process. I think there was some effort to do a little bit of the required analysis under Dodd-Frank and the Administrative Procedure Act. I think that probably counts for the delay, right? They used the 1022 information request to gather some data to help them I think inform a bunch of different things. One of which might be the larger participant rule.

Chris Willis:

Yeah. Having talked about those rulemaking proposals, I'd like to turn to sort of regulatory developments and pressure with regard to fintech bank partnerships. It's such a large aspect of the market today. Those partnerships are very popular among both banks and their fintech partners. There are tons of them in the market. But also, it seems like there's a lot of regulatory scrutiny of and pressure on those arrangements. Do you mind talking about that for a minute?

James Kim:

Yeah. Sure. There are a couple of things I think that we could just touch upon at a high level. I mean, because we could spend an hour going into detail on any of these topics. In no particular order, all three major prudential federal regulators, the OCC, the Federal Reserve and the FDIC all issued consent orders focusing on these banking as a service fintech bank partnership.

I would just note to everybody, you could easily look those up. But in my career in this space, you went from maybe one or two in the decade beforehand to each agency issuing a consent order last year in this space. And then the other development is more and more states, right? The ones that I could tick off immediately are Minnesota, Connecticut, Nebraska, Florida, Maryland, Washington State and then Washington, D.C. have all passed legislation seeking to reign in these partnerships. They have basically true lender-type attacks baked into the legislation in some way, shape, or form.

Often, but not always, but often codifying predominant economic interest and having other anti-evasion provisions, so that their state usury laws, and state lending licensing requirements and other regulations are not preempted by federal banking law.

And then the preemption point, taking it to the furthest, you have, finally, Colorado that has a bill to actually opt out of the relevant section of the FDIA's rate exportation for state-chartered banks. If that goes into effect and it's final and signed, Colorado would join Puerto Rico and Iowa as the only opt-out jurisdictions.

Chris Willis:

Yeah. And it's important for you to point out that state legislation, James. Because I think the fact that so much of it has happened already in the states that you mentioned has got to be a good predictor of more to come don't you think?

James Kim:

Yeah. I mean, before legislation, you just had certain states just aggressively through enforcement kind of press the true lender issue. The next step is obviously passing legislation. And I think the kind of the smaller nuance thing within this trend that I would point out is they're not always obviously blue states, right? I mean, you get Nebraska in there. You get Florida in there. I think state desire to rein in high interest rate lending and protect their usury caps or enforce their usury caps is really bipartisan.

Chris Willis:

Having talked about that, let's turn to another product that is I think very strongly associated with fintech in the marketplace and in the minds of lawyers, and regulators and consumers. And that's buy now, pay later products, which were really pioneered by a number of fintech companies.

It seems like there's been a pretty significant ramp-up in regulatory interest in buy now, pay later. And that that's actually moving forward in some ways. Can you talk about that for a minute?

James Kim:

Sure. Back in '22, the CFPB issued market monitoring orders to several large buy now, pay later companies. That data was used to issue a report last year in 2023. I think that's the big – kind of one of the huge developments in the space is the report, right? Everyone should read the report. The report is obviously a precursor to something. We don't know what it is. But the CFPB is building an empirical record to justify could be rulemaking, could be lots of things. Or a combination of things. Supervision, enforcement activity. Whatever it might be. Larger participant rule for buy now, pay later. I don't have a crystal ball. But certainly, the data is going to be used for something.

And then New York very recently, it was the end of the year, kind of the state of the state address in New York, the governor announced plans to do a lot of things. One of which was to introduce buy now, pay later legislation, which would empower the New York Department of Financial Services to issue more rules and regulations concerning that. Product licensing is the most obvious one.

But the governor specifically called out strong consumer protections, disclosure requirements. She flagged dispute resolution, credit reporting standards, limits on late fees. Those are actual caps, right? And then privacy and data security issues. I think that's something to look forward to. And then if New York does it, will California? Will other states kind of jump on the bandwagon?

Chris Willis:

Yeah. And it seems reasonably likely that that could occur too. Another product that I think has been both pioneered by fintech companies and the subject of a whole lot of regulatory activity both at the federal and state level is earned wage access. Can you tell us like kind of what happened over 2023 and what do we think is going to happen in the coming year with respect to EWA products?

James Kim:

Yeah. Earned wage access I think is a similar life cycle to buy now, pay later. It exploded in popularity in the last couple of years. And then the government agencies, state legislatures are catching up now.

What happened in 2023? You have several states who actually enacted legislation or guidance, which is in effect, right? So, that's California, Connecticut, Kansas, Maryland, Missouri, Nevada, Washington. And then the same number or more states have pending bills or proposed legislation. Again, California. Again, Florida, Georgia, New Jersey, New York. I think there are others, right?

And then you have an FTC lawsuit against FloatMe and then their settlement with Brigit. And then I think everybody's expecting the CFPB to issue a new advisory opinion. Now, if you remember years ago under Director Kraninger, they issued an advisory opinion on earned wage access basically saying it's not credit under TILA and Reg Z.

When Director Chopra took over, one of the first things he did in the first couple of months was basically to rescind that advisory opinion. And then I think the handwriting is in the wall that the current leadership at the CFPB will issue their own advisory opinion. I thought it might have happened at the end of last year. But I would expect Q1 certainly by the summer of this year. But I'm betting Q1 of this year. We'll see what that is. But I'm confident they're going to call it some form of regulated credit.

Chris Willis:

And in that vein, James, it feels like one of the real trends that we saw in 2023 was the tendency of regulators, both federal and state, to take products that didn't think they were credit and call them credit. Like earned wage access, income share agreements, PACE financing transactions. Now with the CFPB's new proposed rulemaking, overdraft fees. And so, every time that someone wants to design a product in order to make it not credit, the regulators seem to deem it credit anyway.

James Kim:

Yeah. I feel like that's a very common reaction by regulators, right? With anything new that's innovative, they want to shove it into an existing box, right? Which is much easier than taking the time to come up with some new, tailored, appropriately calibrated regulation.

I think the point is – and we work with a lot of companies in this space. The responsible companies, they invite licensing and regulation. The only question is why are you shoving the square peg through the round hole and treating what is a new product that's supposed to be a better alternative to existing high-interest rate, short-term, small-dollar products and just forcing them into that category?

I mean, if I'm a company, you're forcing me to basically be subject to payday regulations. Then why not just charge the maximum rate allowed in that state for payday loans? Because you're going to make me do all the other stuff anyway, right? I mean, it's an unfortunate pattern. It's just – I don't know what else to say.

And then you get a state like Connecticut that it's like to an extreme. They didn't just call earned wage access and say it's covered under existing consumer lending laws. They amended the laws to make it more expansive and expanded the definition of finance charge to be even more than it was, right?

Connecticut is an example of finance charge is not only the traditional kind of interest finance charge definition. It's everything that would be considered a finance charge to be calculated under the MAPR under the federal MLA rules. Plus, any other fee, optional or not, voluntarily or not. I mean, it's got this very expansive. Connecticut took everything you said and then they said, "I call and then I increase the bet by 3X."

Chris Willis:

Right. Exactly. Well, that's I think another trend I think that we will be seeing more of in the coming year, for sure. And let me close by just making some comments about another thing that's sort of very impactful from a fintech standpoint, and that's the role of machine learning and artificial intelligence in fintech products.

2023 saw no respite from the regulator's continuous desire to cast dispersions at the use of this technology in consumer financial services. And it seems like they can't go a couple of months without making some statement about the bad aspects of machine learning and AI.

One of the interesting things here, and it's really manifested in a circular that was released by the CFPB in the fall of 2023, is the apparent desire to use adverse action. And the requirement of adverse action notices under ECOA as the lever to control the use of alternative data and machine learning models.

And so, you see this drive to incredible specificity and adverse action reasons, which is totally inconsistent with the way Reg B and the Reg B model forum treat adverse action reasons. But it appears to be part of an effort to control financial services companies and creditors in particular from using certain types of data that the Bureau doesn't want used in credit decisions like social media, shopping data or things like that. And they've decided that adverse action is sort of the easy way out in terms of putting pressure on creditors' models.

I think we're going to continue to see in 2024 more sort of bad public statements about the use of machine learning and AI, actual pressure on adverse action both in supervision and potentially in enforcement. And then it remains to be seen whether there will ever be sort of a frontal assault of saying machine learning is bad and it's discriminatory, for example, under the Equal Credit Opportunity Act or some other fair lending law. We have not seen that yet. It'll be interesting to see if that happens in the credit underwriting context. But, definitely, fintech companies and the banks that partner with them have to be very aware of risks here.

And I would say the other sort of regulatory development that was foreshadowed early in 2023 and now has really come home to roost in supervision is the demand by the CFPB that creditors who use models, especially machine learning models, engage in less discriminatory alternative testing before they implement those models. That wasn't a common practice in industry and probably today still isn't. But it was enunciated very informally, by the way, by people from the CFPB's fair lending office, Patrice Ficklin in particular, in statements at conferences. And now we see the CFPB actively demanding that that occur as a part of the model development process through the supervision that it has of covered financial institutions.

And so, for fintech companies and especially those that partner with banks, that less discriminatory alternative search I think now becomes a mandatory part of any model development exercise. That's another sort of brand-new development towards the tail end of 2023 that I think is going to really reverberate throughout the next year.

Anyway, thank you to our listeners. And, of course, thanks, James, for sharing your insights on this podcast. Don't forget to visit and subscribe to our blogs, TroutmanPepperFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And while you're at it, why not go over to Troutman.com and visit us there and add yourself to our Consumer Financial Services email list? That way we can send you copies of the alerts and advisories that we send out as well as invitations to our industry-only webinars. And don't forget about our handy mobile app available both for iOS or Android. Just search for Troutman Pepper in your app store. And, of course, stay tuned for a great new episode of this podcast every Thursday afternoon. Thank you all for listening.