

Congressman Bill Posey
2150 Rayburn HOB
Washington, DC 20515

Dear Representative Posey,

Thank you for the opportunity to testify before the subcommittee on January 30, 2018, at the hearing “Examining Opportunities and Challenges in the Financial Technology (‘Fintech’) Marketplace.” I am happy to provide answers to the posthearing questions (numbers 3, 4, and 5) you posed to me in your letter of February 21, 2018.

Question 3: What is the number one challenge of the rapidly growing fintech sector that cannot be addressed by the existing constellation of federal and state regulations or related laws?

Ironically, the number one challenge facing the fintech sector likely *is* the existing constellation of federal and state regulations or related laws. Specifically, the cost, complexity, and limitations posed by state-by-state regulation of nonbank lenders and money transmitters, combined with overarching federal regulation, risks placing nonbank fintech firms at a significant competitive disadvantage to their bank brethren, even if they offer equivalent products or services.¹

To address this risk, the inconsistency and cumulative burden of regulation should be reduced to the greatest extent possible. There are several options to address this. These options include the pure federalization of financial services regulation, preempting the states entirely; the use of federally granted passporting of certain elements of a firm’s home-state law and licensing, similar to what state-chartered FDIC-insured banks currently enjoy under federal law; or states harmonizing their laws so that they are consistent.²

Question 4: Does the growth of the fintech sector really present new and pressing regulatory challenges, or are the regulatory solutions and needs being presented really issues that are being raised from other problems that are already on our radar screen?

The growth of fintech presents some challenges that, while not completely novel, are particularly acute within fintech at present. For example, questions about whether fintech lenders should be allowed to lend across state lines on the basis of their home-state law reflect the debate around banks in the 1970s and early 80s that resulted in section 521 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDA) granting state-chartered FDIC-insured

¹ For more on the problems of inefficiency, competitive inequity, and potential political inequity created by some state-by-state regulations, please see Brian Knight, “Federalism and Federalization on the Fintech Frontier,” *Vanderbilt Journal of Entertainment & Technology Law* 20, no. 2 (2017): 129–206.

² Brian Knight, “Modernizing Financial Technology Regulations to Facilitate a National Market” (Mercatus on Policy, Mercatus Center at George Mason University, July 2017).

banks regulatory parity with their nationally chartered peers.³ The purpose of this provision was, as Senator Dale Bumpers, a proponent of DIDA said, to “allow[] competitive equity among financial institutions, and reaffirm[] the principle that institutions offering similar products should be subject to similar rules.”⁴ The parallels between this historical example and the situation facing nonbank fintech lenders—and, to a degree, money transmitters—are clear.⁵

Likewise, while cryptocurrency (broadly defined) may present significant regulatory issues, many of these issues are driven by the particular uses (e.g., money transmission, investment) a cryptocurrency is being put to. Therefore, the regulatory issues present in money transmission, corporate securities, commodities, the sale of property, et cetera, will be present in the cryptocurrency space as well.

While the underlying issues may not be entirely novel, the combination of issues presented by fintech may be. To take cryptocurrency as an example again, while the regulation of commodities, securities, money transmission, and the sale of property are all existing issues, cryptocurrency may combine them or blur the lines between them in ways that are, if not completely unique, at least uncommon relative to more traditional methods of providing those same services. Thus, the unique regulatory challenge may not be a new type of transaction, but clarifying the barriers between existing bodies of regulation.

Question 5: We’re aware that our national financial system sometimes shines a light on differences in the way states regulate activity and differences between states and the federal government. In the insurance sector, many experts point to the National Association of Insurance Commissioners as having provided an excellent service of coordinating insurance regulation. Federal regulation of insurance is very sparse. Should we try to encourage better coordination among the states as a way to cut back on some of the federal intervention in financial markets?

Congress should encourage better coordination but be realistic in its expectations of what that will accomplish. For example, Congress has asked the states to coordinate their regulation of money transmitters since at least 1994,⁶ but so far the regulation remains highly fractured.⁷ Given the political and practical challenges with state coordination, and the risk that even if state

³ Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, § 521, 94 Stat. 132, 164–65 (1980) (codified as amended at 12 U.S.C. § 1831d (2012)).

⁴ *Greenwood Tr. Co. v. Massachusetts*, 971 F.2d 818, 826 (1st Cir. 1992) (quoting 126 CONG. REC. 6907 (1980) (statement of Sen. Bumpers)).

⁵ The issue of the fractured state of money transmission regulation has long been on Congress’s radar, including its express desire to have the states harmonize their regulations with each other, a desire that goes back at least as far as 1994.

⁶ See Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, § 407(b)(1)–(5), 108 Stat. 2160, 2248 (1994) (codified as amended at 31 U.S.C. § 5311 (2012)).

⁷ See generally Thomas Brown, “50-State Survey: Money Transmitter Licensing Requirements” (Great Neck, NY: National Money Transmitters Association) (cataloguing the licensing and investigation requirements for money transmitters within each state); see also Kevin V. Tu, “Regulating the New Cashless World,” *Alabama Law Review* 65, no. 77 (2013): 91, 110.

coordination were achieved it would break apart over time,⁸ it is questionable whether state coordination alone will become or remain an adequate solution.

However, this does not mean that Congress must entirely federalize fintech regulation. Instead, it should consider areas where it can allow the states to remain the primary substantive regulators but enable state-chartered or licensed entities to serve a national market via federal regulation. As discussed earlier, the use of federal law to allow state-chartered, federally insured banks to compete with their nationally chartered brethren, while leaving the substantive chartering and lending requirements to the states, provides a useful example. Congress could enable competitive federalism by allowing state-chartered or licensed entities to export their license or powers on par with the relevant powers of national banks.⁹

I hope this additional information is helpful in the committee's consideration of the regulation of fintech. Please feel free to contact me if I can provide any additional information.

Sincerely,

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⁸ Such drift has been seen in other contexts, including the Uniform Commercial Code (UCC). See generally John C. Minahan Jr., "The Eroding Uniformity of the Uniform Commercial Code," *Kentucky Law Journal* 79, no. 4 (1976): 799–822 (discussing how factors including amendments, subsequent state laws, and judicial decisions had reduced the degree of similarity between all states that nominally enacted the UCC).

⁹ For more on potential options see Knight, "Modernizing Financial Technology Regulations"; see also J. W. Verret, "A Dual Non-Banking System? Or a Non-Dual Non-Banking System? Considering the OCC's Proposal for a Non-Bank Special Purpose National Charter for Fintech Companies, against an Alternative Competitive Federalism System, for an Era of Fintech Banking" (George Mason University Law & Economics Research Paper No. 17-05, Arlington, VA, 2017), 35–37.