

Insights: Alerts

Recent Legislative and Enforcement Developments in the FinTech Sector

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In late September, Representative Patrick McHenry (R-NC), vice chair of the House Financial Services Committee, introduced the “Financial Services Innovation Act of 2016,” which is intended to promote innovation in financial services and provide a streamlined regulatory process for innovative FinTech products.

The Federal agencies covered by the bill include the Federal Reserve, CFPB, CFTC, HUD, Treasury, Farm Credit Administration, FDIC, FHFA, FTC, NCUA, OCC, and SEC. The bill would require each covered agency to publish in the Federal Register within 60 days of enactment and biannually thereafter a nonexclusive list that identifies three or more areas of existing regulations that apply or may apply to a “Financial innovation” and that the agency would consider modifying or waiving if it received a petition relating to that regulation as contemplated by the bill. “Financial innovation” is defined as “an innovative financial service or product, the delivery of which is enabled by technology, that is or may be subject to an agency regulation or Federal statute.”

The bill would call for each covered agency to establish a “Financial Services Innovation Office” (FSIO) to support the development of financial innovations, coordinate with FSIOs at other agencies to share information and data, and establish procedures to reduce the time and cost of offering a financial innovation to the public and enable greater access to financial innovations. Each agency would appoint an individual to serve as the director or the agency’s FSIO.

Companies would be able to petition for an “enforceable compliance agreement” with the FSIOs that, if approved, would allow them to provide an innovative product or service under an alternative compliance plan, which waives or modifies regulation that is out-of-date or unduly burdensome. The petition would need to contain certain content requirements. Multi-party petitions would also be permitted. While a petition is pending, the bill would create a safe harbor barring the agency from bringing an enforcement action relating to the financial innovation that is the subject of the petition.

The agency would be required to publish the petition in the Federal Register within 30 days after receipt and also generally provide a 60-day notice and comment period. If the agency has a “rational basis for doing so and if the agency determines that a provision of a Federal statute under which the agency has rulemaking authority or an agency regulation is burdensome to the covered person,” the agency would be required to modify or waive the application of the Federal statute or agency regulation with respect to a covered person whose petition has been approved. With respect to a covered person whose petition has been approved, each FSIO would work with the covered person to address issues of how existing regulatory frameworks apply to the financial

innovation that is the subject of the petition, assist the covered person in complying with the requirements of Federal regulators of the financial innovation, and assist the covered person in responding to any challenges to a modification or a waiver granted.

If the agency disapproves a petition, it would be required to provide the petitioner with a written notice that explains why the petition was rejected. Petitioners would be able to revise and resubmit a petition after disapproval. There would also be a moratorium from agency enforcement action against a petitioner relating to the financial innovation that was the subject of a petition that was disapproved. Judicial review of an agency's determination on a petition would also be allowed.

The "enforceable compliance agreement" would also prohibit other agencies from bringing an enforcement action against the petitioner with respect to the financial innovation that is the subject of the agreement. States would generally be prohibited from bringing an enforcement action if the petitioner has provided the state with a copy of the enforceable compliance agreement and a statement of policies and procedures the petitioner has in place to comply with applicable state laws. However, the bill would permit states to bring an enforcement action if a court were to determine "that the agency's action was arbitrary and capricious and the financial innovation has substantially harmed consumers within such State."

If an agency has not received a petition within five years of the date of establishment of the agency's FSIO, the agency would need to eliminate the FSIO, while continuing to honor any enforcement compliance agreement of another agency.

It does not appear that the bill would provide a safe harbor from civil litigation. However, the bill would allow a petitioner to "elect to arbitrate any action initiated by another person relating to a financial innovation that is the subject of an enforceable compliance agreement." It remains unclear whether this provision would trump the CFPB's arbitration rule once it is finalized and becomes effective. Earlier this year, the CFPB proposed to ban covered providers of consumer financial products and services from including pre-dispute arbitration clauses in new contracts that bar a consumer from filing or participating in a class action with respect to the covered consumer financial product or service.

Given that this is an election year, it seems unlikely that Congress will take any action on this bill in the near-term. However, the FinTech sector appears to be ripe for further legislative and/or regulatory activity in the coming months. In July, Rep. McHenry introduced two other FinTech bills, the "Protecting Consumers' Access to Credit Act (H.R. 5724)" and the "IRS Data Verification Modernization Act (H.R. 5725)." Furthermore, the CFPB launched "Project Catalyst," an initiative for facilitating innovation in consumer-friendly financial products and services in November 2012, and also issued a final policy statement on issuing "no-action" letters for innovative financial products or services in February 2016.

Consumer financial services providers continue to face an increasingly complex regulatory landscape, and financial innovation and the rise of FinTech have compounded the need for strong compliance management systems. In a recent enforcement action, the CFPB took action against Flurish, Inc., doing business as LendUp, an online lender, for allegedly failing to deliver the promised benefits of its products. In the CFPB's press release announcing the enforcement action, Director Cordray specifically highlighted how LendUp "pitched itself as a consumer-friendly, tech-savvy alternative to traditional payday loans, but it did not pay enough attention to the

consumer financial laws.” According to Cordray, “[t]he CFPB supports innovation in the fintech space, but start-ups are just like established companies in that they must treat consumers fairly and comply with the law.”

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