AMERICAN BANKER

Fintech Shouldn't Have EZ Pass into Banking

By David Gibbons
April 7, 2016

American Banker recently reported on fintech companies approaching the Office of the Comptroller of the Currency about applying for national bank charters. Another recent *American Banker* article discussed a plan by some House Republicans to give federal preemption to technology companies.

Both articles brought back memories of Internet companies seeking national bank charters during the dot-com hype of the late 1990s and early 2000s. Part of my job then at the Office of the Comptroller of the Currency was to review, skeptically, the applications for proposed Internet banks. Now, I'm urging regulators and lawmakers to exercise healthy caution before granting fintech businesses the preemptive powers they are seeking via nationally-chartered banks or otherwise.

I am well aware of the risks of being close-minded when it comes to financial innovation. But before anyone gets too enamored about the technology, regulators need to understand the application behind the technology of a firm seeking banking powers. For instance, is it the technology that makes the money or is it another activity that the technology enables that makes the money?

For example, a number of fintech firms use technology to enable higher risk and higher return on consumer finance businesses such as payday lending and other forms of subprime lending. Before providing these firms with preemptive powers and access to federally-insured deposits, regulators and lawmakers alike will need to look through the technology hype to the underlying business model. They need to ask hard questions to understand what safety and soundness, compliance, and perhaps public policy, issues are present.

When it comes to subprime consumer finance, the potential for higher returns means one of two things. Either the returns are needed to support the risk, or they are not. If the former is true, regulators will need to require heightened reserves, capital and risk management to compensate for the expected and unexpected risks. Even if a high rate of return is necessary to compensate for risk levels, a regulator may wonder whether a normalized profit stream — like that of a traditional bank — is more appropriate to build adequate capital reserves.

If, on the other hand, higher returns are not needed to compensate for the risk, regulators and lawmakers will need to question and consider their appropriateness for different reasons. As the Smith Barney commercial used to go, do they "make money the old fashioned way" by earning it? Or are some of these businesses just gouging needy and/or unsophisticated consumers? If the latter is the case, consumer financial product companies should not preempt state consumer protection laws.

Meanwhile, regulators' efforts to combat money-laundering and terrorism finance mean cryptocurrency businesses and other new-frontier providers that enable instant value exchanges, which are inquiring with the OCC about federal charters, will deserve particularly close and careful inspection. Anti-money laundering efforts are hard enough to police and detect for traditional banks built around a centralized system. The relative lack of transparency for virtual currencies makes those efforts significantly more difficult.

Technology has advanced financial innovation and will continue to lead to progress in delivering financial services. But wolves in technology clothing must be kept at bay.

David Gibbons is a managing director with Alvarez & Marsal Financial Industry Advisory Services in Chicago, specializing in all aspects of enterprise risk management. He was formerly chief risk officer for HSBC Holdings in North America and a deputy comptroller of the currency for both credit risk and special supervision at the OCC.
