

FINANCIAL SERVICES INNOVATION ACT

Promoting innovation in financial services

We need to
rethink regulation.



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THE PROBLEM

- **Financial regulations aren't clear and the laws are outdated:** increases the time and cost of getting new ideas to market
- **The US is not globally competitive:** UK has fintech sandbox and, as a result, talent is going to London
- **Command-and-control regulation doesn't work:** "Often, if [regulators] see something that is new and we don't necessarily have a framework for analyzing it, the reaction might be either to say 'no' or to let it languish." -- OCC Regulator

THE SOLUTION

- Provide an opportunity for innovators to beta test without devastating consequences
- Attract and keep talented fintech innovation in the US
- Provide regulators with the ability to work with innovators to promote responsible innovation

So we created a new model for regulating fintech, called:

FINANCIAL SERVICES
INNOVATION OFFICE
(FSIO)

FSIO AT EACH AGENCY

CFPB, CFTC, FCA, FDIC, FHFA, FRB, FTC, HUD, OCC,
NCUA, Treasury, and SEC

- The FCA is the Farm Credit Agency, it regulates and examines banks related to the Farm Credit System, including “Farmer Mac,” part of Dodd-Frank
- The FTC has been named as a preferred regulator by some fintech and technology companies

Note: If an agency has not received a petition within 5 years of the date of the establishment of the agency’s FSIO, the FSIO shall be eliminated at that agency

WHY NOT HAVE ONE, BIG INNOVATION OFFICE?

- It's slow and clunky
- Destroys agency expertise
- Protects regulators from having to modernize and compete



STILL....CENTRALIZED COORDINATION IS GOOD!

So we created an **FSIO Liaison Committee**, that will:

- Facilitate cooperation, information, and data sharing
- Encourage uniform principals and standards at each FSIO
- And provide public field hearings so that startups can get informal advice and gather information and the latest technologies



AN INVITATION TO INNOVATE

In the beginning, the agency must:

- Announce the establishment of the FSIO, and
- Provide a nonexclusive list of at least three regulatory areas that the agency is considering to modify for the program (this happen 2x annually thereafter)

WHY?

Forces the hand of the regulators to:

- Meaningfully open its doors to innovators
- Recognize that there are regulations that should have more flexibility for innovation
- And it nudges the companies to apply with less fear

SO WHAT'S REQUIRED?

Each FSIO shall perform the following tasks:

- Support the development of innovative financial technology
- Establish procedures to reduce the time and cost of offering a financial innovation to the public
- Enable greater access to financial innovations

THE PETITION PROCESS

FILE A PETITION

- Anyone who owns or operates a company that has an innovation in financial services subject to the agency's jurisdiction can petition for acceptance into the FSIO program
- In other words, startups, credit unions, community banks, large banks and tech incumbents can all apply to the agency of their choosing!

CONTENTS OF THE PETITION

- Identify the agency rule or statute for which the modification or waiver is sought and the alternative compliance strategy that is proposed
- Identify the product or service to which the modification or waiver would pertain
- Demonstrate that under the alternative compliance strategy, the financial innovation—
 - A. Serves the public interest;
 - B. Improves access to financial products or services; and
 - C. Does not present systemic risk and promotes consumer protection

THE PROCESS

- Notice and comment: formal rulemaking applies, but this can be waived if the agency determines that the covered person submitting the petition is similarly situated to another covered person that has been granted approval already
- Confidentiality: the agency shall maintain the confidentiality of any non publicly available data or information in the petition, and notice and comment shall not constitute a waiver of privilege.
- Multiparty petitions: parties may join on the petition for consideration by the agency

THE DECISION

- The agency will have 30 days after notice and comment period to accept or deny the petition
- For approval, the firm needs to show that it is "more likely than not" that the firm meets the requirements of establishing an alternative compliance strategy.
- For rejecting the petition, the agency has some work to do...

REQUIREMENTS FOR DENIAL

The agency must perform a formal cost-benefit analysis that contains the following:

- Any beneficial effects that are both quantifiable and quantitative, and the identification of those likely to benefit from rejecting the petition
- Any potential costs of the rule, including any adverse effects that are both quantifiable and quantitative, and the identification of those likely to bear the costs of rejecting the petition
- The definition of a baseline against which to measure the likely economic consequences of rejecting the petition

AND AFTER THE DENIAL...

- Companies can resubmit a revised petition to address the agency's concerns
- As for the risk of enforcement, there's a moratorium before the agency can consider taking an enforcement action against the covered person
- The company can seek judicial review if the denial is arbitrary or capricious

WHAT IF THE FSIO SAYS YES?

Then the agency and the business enter into

ENFORCEABLE
COMPLIANCE AGREEMENT

THE IDEA

- No action letters have been ineffective in achieving regulatory flexibility because they are not enforceable, not transferrable, and can be revoked at any time
- So we created something a little more innovative...



HOW DOES AN ECA WORK?

- Enforceable across all other agency and state jurisdictional lines: if you are accepted at the OCC, another agency cannot go after you
- Provides flexibility so that if the business does not want to enter into the ECA, it doesn't have to; and if the business fails to satisfy requirements of the ECA, the agency can break the contract
- Creates a compliance plan, including: testing, feedback, and time limitations

POTENTIAL LEGAL ISSUES

By granting the agency the authority to enter into an ECA, potential issues include:

- Competitors may sue for competitive advantage
- Special interest groups may sue for agency failure to enforce the law
- State licensors may sue over preemption

THE SOLUTION?

We give the agencies the legal authority to do this by granting them:

Expressed waiver authority

WHAT DOES THAT MEAN?

- The agency has the authority to waive statutory requirements, gap-filling regulations, supervisory and compliance requirements, and guidance materials, so long as the Agency's reading of its rule or statute is rational.
- Rationality requires a simple showing that the agency has rulemaking authority, or an agency regulation is burdensome to the covered person.

A SHIELD AGAINST CLASS ACTION LIABILITY...

ARBITRATION.—A covered person may elect to arbitrate any action initiated by another person relating to a financial innovation that is the subject of the enforceable compliance agreement.



What about the state preemption issue?

A State regulator may not commence an enforcement action against the covered person with respect to the enforceable compliance agreement, if the covered person provides the State with:

- The enforcement compliance agreement; and
- A statement of policies and procedures the covered person has in place to comply with State laws that are applicable to the financial innovation

BUT...

STATE EXCEPTION FOR CONSUMER HARM.

A State may commence an enforcement action against a covered person with respect to a financial innovation that is the subject of an enforceable compliance agreement if, in an action brought by the State in a court of competent jurisdiction, the court determines that the financial innovation has harmed consumers within such State.

FAQs

So are the FSIOs the gatekeepers for innovation?

Absolutely not. Participation with FSIOs is completely optional. While it is our hope that this bill will be beneficial, this is not creating permission-based innovation.

Is this bill more of a solution for non-bank fintech firms versus banks?

Again—absolutely not! Big banks, regional banks, community banks, credit unions are all considered “covered persons” for this bill. This bill levels the playing field AND promotes innovation.

Well, wait. Is this just for banks then?

NO!!! Tech incumbents all the way down to startups are also considered “covered persons.” Indeed, that is why we included the FTC as one of the agencies of jurisdiction for this legislation.

So, it’s for ANY innovation in financial services?

Yep. From peer-to-peer lending to payments to small business financing to remittances to bitcoin to blockchain—to something that is being invented in a lab somewhere right now! We want this bill to be timeless, so that it will help innovation long after even the term “fintech” has gone away. Truly, the possibilities for this bill are only limited by the imagination of the financial innovators themselves.

Isn't this whole thing increasing the size of government?

No! There's a sunset provision that eliminates the agency's FSIO if it's not being used. And the cost of carrying out the FSIOs comes from whatever funds were appropriated by Congress to the agency. So not only is it not increasing the bureaucracy, it's actually forcing a paradigm change on them to encourage innovation, rather than finding ways to oppose it.

What about the states? I'm still confused about how they are involved...

The states have a strong voice in this process! First, they will have a representative as part of the FSIO Liaison Committee. Second, because the ECA requires formal notice and comment, state examiners have the ability to participate in a full and fair hearing prior to an ECA being given. Finally, the states have the right to commence enforcement proceedings against a company even after an ECA has been granted if the state shows that the financial innovation has harmed consumers within the state and the agency's decision was arbitrary and capricious.

Ok, let's talk about the gritty details. Do companies have to wait until the FSIO makes its decision in order to operate? That could be a huge problem for startups...

No way! During the period after the company submits a petition, the agency may not take an enforcement action against the company.

Well, what if the “innovation” is a fraud? How do you prevent abuse of the petition process?

The agency has injunctive relief if the financial innovation presents an immediate danger to the financial system or consumers.

What if the ECA is bad? Do the companies have to agree to it?

Nope. If the company is accepted into an ECA, the company MAY agree to it. Nothing is required for them to actually accept it.

What about at the end of the ECA? What happens after the termination date?

The ECA is required to provide procedures for extending after the termination date.

What if the company has their petition rejected, can they resubmit to another regulator?

Yes. There's no limitation on when or how many petitions you can file to the various agency.

What about agency shopping? Doesn't this bill let companies do that?

Not necessarily. While it is true that companies are given the power to decide which agency to apply for an ECA, this bill has given the FSIO Liaison Committee the authority to ensure that the regulators are collaborating and the FSIOs have uniform principles and standards.

Having said that, healthy competition among the regulators is a good thing! It will force them to better understand the technologies in financial services and to answer important regulatory questions. Regulators need to catch up and promote responsible innovation and this bill is a way to nudge them in that direction.

Financial regulation is complex and fragmented. How does this bill help solve that?

By having a coordinating body that oversees all of the FSIOs. The FSIO Liaison Committee ensures consistency across the agencies and assesses how the laws and rules impact competition and innovation. And it holds public hearings that provide informal setting for the regulators to inform companies on how to navigate DC.

But doesn't this bill create ambiguity and uncertainty?

No, it's the reverse actually. Right now there is tremendous ambiguity and uncertainty in financial regulation, particularly for the most innovative products and services. This bill forces the regulators to step up and answer quite directly (and with the certainty of an enforceable agreement!) what is and is not compliant.

"So, do you have a name for this thing?"

—Everyone

PERMANENT BETA