FinTech and Big Tech Companies Want the Benefits of Banking Without the Responsibilities. Loopholes Could Let Them Succeed.

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Tech companies, from small payment startups to the largest tech behemoths, increasingly want access to the U.S. banking system. There are multiple ways that they can get that access, including: industrial loan companies (ILCs), special purpose national FinTech charters, payments charters and special purpose depository institution charters issued by certain states to cryptocurrency and other FinTech firms.

The U.S. banking system was built to keep banking and commerce separate. That way, huge financial-industrial conglomerates can't wield monopoly power, all corporations can maintain fair access to credit and problems within a troubled bank can't infect other parts of the economy. That necessary barrier was enshrined in the Bank Holding Company Act and reaffirmed in the Dodd-Frank Act in 2010. These special charters threaten to erode that separation, which keeps the economy safe.

These types of special charters give tech companies the chance to take advantage of loopholes to avoid federal consolidated supervision which governs banking organizations at the level of their ultimate corporate parent. Bank holding companies must abide by strict standards outlined by the Federal Reserve, including capital requirements that ensure the parent company can serve as a source of financial and managerial strength for any subsidiaries in distress. Consolidated supervision makes sense for banks and prevents harmful impacts to our financial system.

What are these special charters, and how do they avoid that kind of comprehensive oversight?

- **Industrial Loan Companies:** Banks by another name, essentially. Some cannot offer checking accounts, but they otherwise do what banks do. The FDIC under Chairman Jelena McWilliams finalized a rule in December 2020 governing the supervision of ILC parent companies, but its true effect will be to signal that this charter is a viable back-door option for entering the business of banking without the obligations of consolidated supervision by the Federal Reserve. Allowing commercial firms to integrate ILCs into their business model poses a threat to the wall between banking and commerce and, potentially, a national security risk. The ILC parent company lacks the necessary Fed supervision and capital requirements as well as consumer and data privacy protections.
- **OCC charters:** There are several ways for a Big Tech or FinTech company to gain access to the banking system using an OCC charter. In recent months, we have seen SoFi granted approval to charter a standard national bank and to become regulated by the Federal Reserve on a consolidated basis. Jiko achieved its goal of owning a bank by purchasing an existing national bank. Jiko will also be subject to consolidated supervision by the Federal Reserve. Cryptocustody firm Anchorage Trust Company converted from a South Dakota-state chartered trust company to a national limited purpose trust bank charter. The OCC could grant a range of tech companies from startups to Amazon a back door to the most coveted features of the banking system without requiring them to comply with the full spectrum of bank prudential regulation, including consolidated supervision of the corporate parent. These types of national bank charters include the OCC's "FinTech charter" for lending activities and its "payments charter" for payments activities.
- **Uninsured state-chartered depository institutions:** Kraken Financial and Avanti Financial, two cryptocurrency-focused companies, received approval from the Wyoming Division of Banking for a novel charter known as a Special Purpose Depository Institution (SPDI). These two companies want to take customer deposits like banks do, but without FDIC deposit insurance and the obligation to meet federal bank minimum capital requirements. These SPDIs claim to not need FDIC insurance because they invest only in safe "reserves," but they use the term in a way that no one else does. In normal circles, "reserves" means deposits at the Fed and Treasuries. But the WY SPDIs will invest their customer deposits in all kinds of other debt securities and obligations, including corporate debt, making them no safer than (and in fact exactly like) any ordinary bank. The difference is that ordinary banks have deposit insurance and comply with the duties and obligations that come along with it, like federal bank capital requirements. The SPDIs choose to skip this customer protection because it saves them money, allows them to avoid consolidated federal supervision, and because a regulatory loophole allows it. In short, these SPDIs function just like a money market fund which is an unstable business model for something that otherwise is

and acts like a bank.

When companies engage in the business of banking without consolidated supervision, we know what happens.

Risky or otherwise inappropriate (and sometimes fraudulent) activity incubates in the unsupervised parts of the corporate entity and eventually metastasizes and spills over into the regulated bank entity, wreaking havoc, robbing customers and, ultimately, undermining trust in the banking system, and possibly also leading to financial instability. The reputation of Wirecard AG, a German payments company that once competed with Square and PayPal, has crumbled under allegations that nearly $2 billion went missing, culminating in a globally wrenching fraud scandal. The European Union is revisiting how it regulates large FinTech companies as it digests the Wirecard scandal aftermath.