BANK POLICY INSTITUTE

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

Tech companies, from small payment startups to the largest tech behemoths, want access to the U.S. banking system. Three ways that they can get that access include: (1) state-chartered industrial loan companies (ILCs), (2) national bank charters for companies that provide payments, but not deposit-taking services, under a new plan from the acting chief of the Office of the Comptroller of the Currency, and (3) 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 three types of special charters give tech companies the chance to take advantage of regulatory 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 is considering applications for ILC charters after a long hiatus. It recently proposed clarifications to that plan, but the FDIC still would allow for large commercial firms, including foreign firms, to buy and integrate ILCs into their business models without limits on their commercial activity – a threat to the wall between banking and commerce and, potentially, a national security risk, if a foreign firm gained control of a U.S. ILC and used it to advance its home country's policies. The ILC parent company lacks the necessary Fed supervision and capital requirements as well as consumer and data privacy protections.

- **OCC special purpose national bank charters for payment companies:** This plan could allow tech companies that process payments, but rely on an argument that they don't technically take deposits, to forgo deposit insurance, access the Fed's payment system and open a Fed account. It could grant a range of tech companies from startups to Amazon a back door to the most coveted features of the banking system without expecting them to comply with the full spectrum of bank prudential regulation, including consolidated supervision of the corporate parent.

- **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.