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POLICY & ACTION FROM CONSUMER REPORTS

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On

Disrupter Series: Improving Consumers Financial Options with FinTech

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Summary of major points

- Financial technology has the potential to increase consumer access to safe financial products and return a measure of control to consumers.
- Competition in the marketplace improved prepaid cards for consumers. However, marketplace pressures alone cannot ensure safe financial products. While the Consumer Financial Protection Bureau's prepaid account rule is a positive development toward ensuring that every way is safe to pay, there still exist gaps in law and provider practice that may create consumer confusion and leave consumers vulnerable to losses.
- Industry participants and regulators should continue to work together to ensure that faster payments are safe and user-friendly, and that any areas in which there are open questions about the applicability of the Electronic Funds Transfer Act or the timing with which funds must be made available to consumers are resolved to ensure consumers realize the potential benefits of real-time payments.
- Virtual currencies, digital cash, and distributed ledger virtual currencies may promise increased financial inclusion. However, lawmakers and providers should adopt basic safeguards before offering consumer-facing virtual currency products and services.

Chairman Latta, Ranking Member Schakowsky, Subcommittee Members, thank you for the opportunity to testify today on the opportunities and challenges related to financial technology, or “fintech.” Consumers Union is the policy and mobilization arm of the independent, non-profit organization Consumer Reports. We regularly research and report on financial services issues, including banking, credit, and insurance. We also engage in research and advocacy work to encourage fair financial services, with appropriate public oversight and consumer protections. We appreciate your leadership in investigating fintech, as we believe that it holds promise to increase consumer inclusion and choice without sacrificing consumer safety and security.

Safe Innovation Aligns the Interests of Consumers and Industry

Financial technology holds the promise to increase financial inclusion by solving some of the problems that consumers say have kept them from using traditional bank accounts. New products and services may provide consumers greater control over their financial lives through access to real-time financial information. Others may increase access to the financial mainstream, as these products may be offered at lower cost or be more convenient to use than traditional banking or alternative financial services. These developments may ultimately mean greater inclusion and integration, especially of the underbanked, unbanked and unhappily banked. We encourage service providers to “bake in” consumer protections, as technology often moves at a faster pace than regulation. We further urge lawmakers to ensure that appropriate safeguards are enacted, while still being flexible enough to allow for new products to thrive in the marketplace when they provide meaningful value to consumers.

Contrary to complaints by industry that regulation kills innovation, appropriately tailored regulation ultimately benefits businesses. While financial services regulation is essential for protecting consumers from harm, strong and consistent regulation and supervision of consumer financial services benefits industry by promoting consumer confidence and thereby driving adoption. Strong and consistent regulation also ensures that businesses that take consumer protections and regulatory compliance seriously are not at a competitive disadvantage to those that do not. Lawmakers and regulators should not hesitate to hold these new financial services businesses to the highest standards.

Some of the most exciting developments in financial technology are occurring in payments. It is no small miracle that a mobile phone application can be used to quickly settle a bar tab among friends in seconds. Faster payments systems or rails can decrease the time it takes to receive wages or other needed funds. However, these new products and services are coming from both incumbents and new service providers, and may present unique challenges to regulators, or pose additional risks to consumers unless there are clear rules of the road for fintech.

Cashless Payments

The Consumer Financial Protection Bureau's (CFPB) Final Prepaid Card Rule is one of the biggest recent developments in increasing consumer access to safe financial products. Prepaid cards can be used much like a traditional debit card linked to a bank account, but with no bank account required. These products are often marketed to consumers who cannot get, have trouble with, or choose not to have a traditional bank account, and tend to be used in greater numbers by younger and lower-income consumers.

Our organization has documented the unfair discrepancy between the protections afforded bank debit card users and prepaid card users for many years. In 2004, Consumers Union led a national coalition calling for protections on "stored-value" cards, now called prepaid cards, which led to rule changes that extended protections to employer-arranged payroll cards in 2006. In 2009, we issued our first report on prepaid cards, Prepaid Cards: Second-Tier Bank Account Substitutes. We found that high, multiple, and confusing fees were the norm and that issuers offered little or no protection against fraud and loss. In the years since, our studies have found improvements in prepaid offerings, but issues remained. As recently as 2016, we found that consumers still are likely to have difficulty finding fee information, and that prepaid cards do not yet come with the same mandatory federal consumer protections that consumers with bank debit cards currently enjoy.

The CFPB's final prepaid rule extends long-overdue safeguards to prepaid accounts by closing the gap in protections between bank account debit cards and prepaid cards. The final rule:

- Protects prepaid card users against fraud and unauthorized charges;
- Helps consumers comparison shop with a simple fee chart on the outside of the package, with more details on a longer chart on websites and inside the package at retail;
- Requires that prepaid cards that permit an overdraft line of credit comply with credit card laws, including ability to pay, limits on fees in the first year, and rules giving consumers time and control over how to repay; and
- Ensures that consumers have convenient access to account information by providing free access to statements upon request and free balance information by telephone.

Once the rule takes effect in 2018, consumers will be able to compare prepaid cards more easily to find the most affordable option and have the peace of mind that their money will be safe if their card is lost or stolen.

The final rule extends to mobile wallets that store funds, a huge boon to consumers reliant on mobile wallets, or who enjoy the convenience of peer-to-peer payments systems. These products and services, while increasingly popular with consumers, may include complex liability chains. For example, when a consumer makes a mobile payment using an app that draws funds from her account, she may think of the service provider as the source of a remedy if the funds are misdirected. In fact, a number of third-party service providers' terms and conditions explicitly direct consumers to contact their bank if they detect something wrong, which may be counterintuitive to consumers. Moreover, some providers may not have a telephone point of contact to resolve issues, even something as simple as where to find the terms and conditions of the service. So while the CFPB final prepaid rule ends the days of prepaid cards as second-tier bank account substitutes, there are still gaps to close. To that end, we urge lawmakers and regulators to take additional steps to make every way safe to pay. We recommend:

- Banning overdraft lines of credit;
- Requiring that funds held by service providers be structured to qualify for pass-through deposit insurance;

- Prohibiting abusive fees;
- Barring the use of forced arbitration agreements in consumer financial services contracts;
- Ensuring uniformity among different payment methods by extending chargeback rights to all forms of electronic payments;
- Declaring it an unfair and abusive practice to fail to provide a dedicated, rapid response point of customer service so if things go wrong, consumers know whom to contact to get their money back.

Faster Payments

Faster payments are another area where financial technology promises great improvements for consumer financial services. A number of providers have announced plans to bring faster, potentially real-time, payments to the United States. Consumer use cases for faster payments include sending money peer-to-peer to settle a debt, businesses sending money to consumers, such as insurance reimbursement, and consumer to business, such as bill payment.

Faster payments may prove to be both convenient and money saving for consumers. For example, the ability to send and have the payee receive a bill payment electronically may save a consumer a run to the post office for a money order and a race to the utility's office to pay a bill that's due that day. Speed may also cut down on the incidence of late fees, and reduce reliance on high-cost credit. For example, real-time payments may allow consumers immediate access to pay, allowing people to use money earned the same day – as opposed to waiting days or weeks for payday – and potentially reducing reliance on short-term high-cost loans, payday or overdraft, to carry them until their wages arrive. Together, these benefits have the potential to bring consumers back into formal relationships with financial institutions by reducing or eliminating the unpredictable fees that may drive consumers away from traditional checking accounts.

In 2015, the Federal Reserve established the Faster Payments Task Force (FPTF) as part of its broader effort to improve the US payments system. The Task Force is made up of more than 300 organizations, including banks and credit unions, technology solution providers, merchants, consumer interest organizations, academics and government end-users. One of the goals of the Faster Payments Task Force was to identify effective approaches for implementing faster payment capabilities in the United States. To do so, Task Force members developed Effectiveness Criteria (EC) by which to evaluate proposals for faster payments capabilities. The 36 Effectiveness Criteria broadly cover six key areas: Ubiquity; Efficiency; Safety and Security; Speed; and Governance.[1] While developed for the evaluation of new payments solutions, the Effectiveness Criteria are an excellent blueprint for lawmakers, regulators and financial services providers looking to ensure safe, inclusive financial products and services.

How we get to a new, faster payments system in the United States largely remains to be seen, and we hope that providers will develop systems in accord with the Effectiveness Criteria crafted by the Task Force, and to adopt these additional protections:

- Consumers should have access to transaction information throughout the payment life cycle, whether it's in days or seconds;
- Features should match consumer expectations;
- Providers should promote consumer understanding of features, terms and cost;
- Providers should work together to establish minimal acceptable standards for user interface;
- Providers should ensure that consumers can easily enter and exit systems;
- Payments should not result in overdraft; rather, credit should be extended through a credit product in compliance with credit laws, in a manner so that consumers can make a conscious, affirmative and separate use of credit and can compare credit options;
- Consumers should have free and convenient access to account information, transaction data and customer service;
- Providers should offer robust customer care to ensure consumer remedies;

[1] For the complete document, *see* https://fedpaymentsimprovement.org/wp-content/uploads/fptf-payment-criteria.pdf.

- Parents should be able to exercise control over use by minors;
- Consumers should have control over scheduled payments, including a right and ability to easily revoke or change the parameters around scheduled one-time or recurring payments;
- Systems should be designed to prevent, detect, remedy and punish fraudulent uses, and incentives should be appropriately aligned to ensure fraud is quickly rooted out;
- Consumers should be able to resolve errors and should not have liability if they were defrauded into making a payment even if the consumer initiated the payment; receiving institutions should have a requirement to return fraudulent payments;
- Seniors, individuals with mental impairments and others should be able to choose to set up controls/tighter fraud blocks;
- Unless a payment is flagged for potential fraud or error, providers should guarantee prompt funds availability and prompt application of payments;
- Consumer protections should be developed by a public process and not by industry alone and rules should be publicly and privately enforceable;
- Banks and nonbanks should be subject to the same rules;
- Universal supervision and enforcement should be conducted by federal regulators;
- Solutions should comply with the Consumer Financial Protection Bureau's Consumer Protection Principles in their entirety;[2] and
- Strong consumer privacy protections should be ensured, with services meeting or exceeding The Digital Standard, which Consumer Reports is leading in open collaboration with other groups to create a digital privacy and security standard.[3]

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[2] *Consumer Protection Principles: CFPB's Vision of Consumer Protection in New Faster Payment Systems* (available at http://files.consumerfinance.gov/f/201507_cfpb_consumer-protection-principles.pdf)

[3] Available at https://www.thedigitalstandard.org/the-standard.

While these payment protections are essential for faster payments, we further believe that all cashless payments and payments systems could benefit from adopting them.

Virtual Currencies

Virtual currencies also hold tremendous potential in financial technology as well as considerable consumer risk. Virtual currencies, also known as digital or crypto currencies, are a medium of exchange not issued or backed by a government. While there is some regulation of digital currency businesses at the federal level,[4] many states are grappling with the question of whether these businesses should be licensed as money transmitters. The issue is complicated. The technological innovations that virtual currencies represent may have application far beyond financial services. For example, the central ledgers where decentralized virtual currencies transactions are recorded may one day be used to protect intellectual property rights or to record the transfer of real property. Regulating these businesses as financial service providers would be inappropriate.

When used in financial services, the technology behind virtual currencies, sometimes referred to as distributed ledger, is sometimes positioned as a new payments "rail." Other service providers are more akin to providers of cashless payments, such as mobile wallets that permit virtual currency transactions.

At present, the most pressing consumer protection concerns around virtual currency – where unwitting consumers appear most likely to suffer harm in the absence of regulation – are not technology-specific. These concerns exist because there are businesses built around or on virtual currency protocols that act as financial intermediaries, accepting consumers' value with the promise of storing, transmitting or

[4] Such as the requirement that these firms register as money services businesses with FinCEN, FIN-2013-G001 (March 18, 2013), Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies, *available at* https://www.fincen.gov/resources/statutes-regulations/guidance/application-fincens-regulations-persons-administering.

exchanging it. Whenever businesses come between consumers and their value, they must be accountable, and basic consumer protections must be in place, regardless of the technology used.

Many proponents of virtual currencies tout the potential to increase financial inclusion. It is precisely because disadvantaged consumers may be the first to experience harm that strong protections must be in place before consumers patronize virtual currency providers. For low- and moderate-income consumers in particular, loss of household funds would be especially devastating. Any evaluation of the potential of providers to increase financial inclusion must be based on sound data and consumer protections, not wishful thinking or marketing slogans.

To ensure appropriate consumer protections for consumers using virtual currency-based financial services, we recommend the following:

- Service providers should be subject to extensive background checks on principals, and vigorous review of the business and its activities to date;
- Businesses should be required to hold permissible investments in amounts equivalent to outstanding obligations to consumers;
- Providers should be subject to supervision and examination to ensure safety and soundness, and minimum capitalization and bonding requirements strictly enforced;
- Examinations must ensure providers' strong financial condition, appropriate internal controls, and adherence to applicable state and federal laws and regulations;
- Firms should also be subject to review of their systems and technology for strength and resiliency;
- Regulators and law enforcement should stand ready to act against any company engaged in fraud, misrepresentation, deceit, gross negligence, or any other legal violations, and consumers should be clearly permitted to bring private actions against these providers; and
- Any effort to regulate virtual currency businesses should adopt the recommendations in the Conference of State Bank Supervisors' Model

Regulatory Framework for State Regulation of Certain Virtual Currency Activities.

Conclusion

We believe that new financial products and services should be subject to appropriate public review and oversight by federal and state financial regulators, with a view toward ensuring financial services are safe, transparent and accountable, prior to their introduction in the marketplace. To that end, Consumers Union supports strong state and federal oversight for financial services providers. We further urge financial technology providers to avail themselves of the many resources that will allow them to “bake in” consumer protection at the outset, including but not limited to Consumer Reports’ prepaid card ratings, the Consumer Financial Protection Bureau’s Faster Payments Principles, and the Faster Payments Task Forces Effectiveness Criteria, as well as the recommendations contained herein.

Thank you very much for the opportunity to testify here today.