

MEMORANDUM

To: Republican Members, Committee on Financial Services

From: Financial Services Republican Staff

Date: October 20, 2023

Re: Subcommittee on Digital Assets, Financial Technology, and Inclusion Hearing:
“Modernizing Financial Services through Innovation and Competition”

On Wednesday, October 25, 2023, at 10:00 a.m. (ET), the Subcommittee on Digital Assets, Financial Technology, and Inclusion will hold a hearing entitled: “Modernizing Financial Services through Innovation and Competition” The following witnesses will testify:

Witnesses:

- Mrs. Jodie Kelley, Chief Executive Officer, Electronic Transactions Association
- Mr. Ram Palaniappan, Founder & CEO, EarnIn
- Dr. Jimmie H. Lenz, Director, Master of Engineering in FinTech and Managing Principle, Advanced Research & Financial Services, Duke University
- Mr. Parris Sanz, Executive Vice President, General Counsel, and Head of Policy and Government Relations, WebBank
- Mrs. Mitria Spotsler, Vice President and Director of Federal Policy, Center for Responsible Lending

New FinTech Products Fill an Existing Void

Emerging financial technology companies (fintechs) are offering alternative financial products to meet evolving consumer demand. The term “fintech” is broad, encompassing a range of technologies across the financial services sector. Generally, a fintech firm employs technology to modify and enhance financial services for consumers or businesses. Many established financial institutions have utilized technology or worked with a fintech firm to enhance their services and reach new customers. However, the term “fintech” generally applies to a company employing recently developed technologies to offer financial products in a new or novel way. Comparable to the range of financial products available to consumers, the range of services offered by fintechs is equally broad. Fintech firms may offer products and services in a variety of segments of financial services – including payments, insurance, regulatory and supervisory functions, and cybersecurity, among others.

Recently, there has been a substantial increase in consumer demand. This has led to rapid growth in the number of products or services offered by fintech firms, especially around Earned Wage Access and Buy Now Pay Later. Additionally, the number of banks partnering with fintechs has risen dramatically over the past decade. Restricting access to these products and partnerships or forcing them into a regulatory regime that does not fit their business model will only limit options for consumers and businesses.

Bank-Fintech Partnerships and the Regulatory Landscape

Bank partnerships with third parties are important for a number of reasons. These partnerships allow banks to offer innovative products and services, lower the cost of lending, enhance their consumer interface, grow their deposit base, and preview a future acquisition. According to a recent Ernst & Young study, 55% of banks expect these partnerships to play a very important role in their strategies by 2025.¹

On June 6, 2023, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC), issued final guidance regarding risk management expectations for banks partnering with fintechs.²

Buy Now, Pay Later (BNPL)

The development of BNPL products has provided consumers with more payment options and can empower them to manage their personal cash flow with increased flexibility. Retailers also benefit from using BNPL products as it improves customer choice and boost sales. In short, BNPL provides consumers with responsible ways to budget for their purchases. The data is beginning to reflect these benefits. In 2022 alone, five percent of all online purchases were completed through BNPL offerings.³

It remains to be seen how, or if, the CFPB will regulate in this area. In 2021, the CFPB sent requests for information on the risks and benefits of BNPL to Affirm, Afterpay, Klarna, PayPal, and Zip.⁴ Later, on September 7, 2023, the CFPB issued a report highlighting the role that

¹ Howard Moseson & Mohammed Akuma, *How banks can fix broker fintech partnership models*, Ernst & Young (Mar. 14, 2023) https://www.ey.com/en_us/strategy-transactions/how-banks-can-fix-broken-fintech-partnership-models

² Fed. Reserve System, Federal Deposit Insurance Corp., Dept. of the Treasury, *Interagency Guidance on Third-Party Relationships: Risk Management* (Jun. 6, 2023) <https://aboutblaw.com/8xE>

³ The Global Payments Report For Financial Institutions and Merchants, FIS (2002) *available at* <https://offers.worldpayglobal.com/rs/850-JOA-856/images/ENGPR2022.pdf>

⁴ CFPB Press Release: Consumer Financial Protection Bureau Opens Inquiry into “Buy Now, Pay Later” Credit (Dec. 16, 2021), *available at* <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-opens-inquiry-into-buy-now-pay-later-credit/>.

technology firms play in the payment space.⁵ While the report mostly addressed the companies' use of data, these overarching concerns may also impact BNPL service providers.

Earned Wage Access (EWA) Products

There are two types of EWA products: an employer-based model and a direct-to-consumer model. Employer or payroll-partnered EWA-providers work with an employer to manage earned wage information and offer access to an employee. EWA providers deposit earned wages directly into an employee's account or onto a prepaid card. The employer then collects the repayment amount through payroll deductions or account debits.

Increasingly, both traditional and gig-workers seek flexible arrangements to receive wages faster. In a recent study, “[s]even in 10 middle-market companies say they are already offering some form of earned-wage access and another 24 percent are expecting to offer it soon.”⁶ This demand has led more fintechs to introduce a wider range of products for both full- and part-time employees to receive a portion of their paychecks before payday.⁷

On December 30, 2020, the CFPB issued a compliance assistance sandbox approval order to PayActiv. The sandbox approval order was for two years and included specific criteria related to PayActiv's EWA product.⁸ However, on June 22, 2022, the CFPB rescinded this sandbox approval.⁹ Some states, including Nevada and Missouri, have recognized the importance of EWA. These states have passed legislation related to EWA products - providing greater regulatory clarity, which in turn promotes greater accessibility to such products.

Legislative Proposals

- **H.R. __, Earned Wage Access Consumer Protection Act (Rep. Steil)** – This bill would provide a clear federal framework to allow EWA service providers. Specifically, the bill would set forth operational requirements for EWA providers, which includes disclosure

⁵ CFPB Press Release: Big Tech's Role in Contactless Payments: Analysis of Mobile Device Operating Systems and Tap-to-Pay Practices (Sep. 7, 2023), available at <https://www.consumerfinance.gov/data-research/research-reports/big-techs-role-in-contactless-payments-analysis-of-mobile-device-operating-systems-and-tap-to-pay-practices/>

⁶ Payment trends in 2022, Citizens Bank, available at <https://www.citizensbank.com/corporate-finance/insights/payment-trends-2022.aspx>.

⁷ *The Employer's View of Early Wage Access*, PYMNTS.com (Jul. 25, 2019), available at <https://www.pymnts.com/news/b2b-payments/2019/early-wage-access-employers/>.

⁸ Hosie, Justin and Capurso, Chris, *Earned Wage Access and the CFPB: A Path Toward Regulatory Acceptance?*, American Bar (Mar. 11, 2021), available at https://www.americanbar.org/groups/business_law/publications/blt/2021/03/earned-wage-access/.

⁹ Press Release, CFPB Rescinds Special Regulatory Treatment for Payactiv, Consumer Financial Protection Bureau (Jun. 30, 2022) <https://www.consumerfinance.gov/about-us/newsroom/cfpb-rescinds-special-regulatory-treatment-for-payactiv/>

requirements, dispute resolution policies, and limitations related to fees and other payments, among others.

- **H.R. __, Financial Services Innovation Act of 2023** – The bill allows persons intending to offer a financial innovation to petition specified financial regulatory agencies regarding existing areas of regulation. A petitioner may request a modification or waiver of an agency regulation. The bill sets forth requirements regarding the petition process, a safe harbor for petitioners from enforcement, and enforceable compliance agreements. The bill also establishes Financial Services Innovation Offices at these agencies to assist petitioners.
- **H.R. __, Fostering the Use of Technology to Uphold Regulatory Effectiveness (FUTURE) in Supervision Act** – This bill would require the federal prudential regulators to assess their internal supervisory technologies and submit a report to Congress with an overview of such technologies.
- **H.R. __, Examining Consumer Choice in Digital Payments Act** – This bill would instruct the CFPB and the GAO to conduct a study on BNPL services to help determine the degree to which consumers are utilizing BNPL for retail purchases. Specifically, the study will focus on what disclosures are provided by entities offering BNPL, trends in the BNPL market, as well as other factors that will provide the CFPB and the public with information to help better understand the BNPL market.