WRITTEN TESTIMONY OF
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Subcommittee on Digital Assets, Financial Technology and Inclusion

IN A HEARING ENTITLED
Bureaucratic Overreach or Consumer Protection?
Examining the CFPB's Latest Action to Restrict Competition in Payments

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Chairman Hill, Ranking Member Lynch, and Members of the Subcommittee, thank you for inviting me to testify today. My name is James Kim. I am a partner at the law firm of Troutman Pepper Hamilton Sanders LLP. Today, I am presenting my own views, and not those of my firm or any client of the firm.

Background and Perspective

My testimony and the views I will express today are informed by my tenure at the Consumer Financial Protection Bureau ("CFPB" or "Bureau") and my subsequent practice focusing on payments and financial technology, including many matters involving the CFPB. My clients at Troutman Pepper range from banks and other established institutions to medium-sized and early-stage companies seeking to introduce innovative products and expand choices for consumers in the marketplace.

From 2012 through 2014, I had the privilege of serving at the CFPB, where I was the lead attorney in the Bureau's first enforcement action involving mobile devices and payments. In addition to my duties as an enforcement attorney, I worked with colleagues in the Office of Supervision and supported examinations behind the scenes. I was also a member of an inter-departmental working group focusing on emerging payment products and services. After leaving the Bureau, much of my practice involves helping companies navigate examinations, investigations, and rulemakings involving the agency.

Why Is the CFPB's Proposed Rule Important?

There is no question that consumer payments are regulated by a host of federal and state laws and rules, enforced by a combination of the CFPB, federal prudential regulators, the Federal Trade Commission ("FTC"), the Financial Crimes Enforcement Network ("FinCEN"), and state agencies. The CFPB's proposed rule on Defining Larger Participants of a Market for General-Use Consumer Payment Applications (the "Proposed Rule") does not change the substance of any statutes or regulations. Instead, the Proposed Rule is important for consumers, as well as

companies in the digital payments ecosystem, because it seeks to define the "larger participants" who will be subject to the CFPB's supervisory authority.

The Bureau's power to examine institutions is the agency's most powerful and least transparent tool. Companies supervised by the CFPB must devote personnel and significant resources to host examiners at their offices, respond to information requests and follow-up questions, and address findings. Examinations are non-public and often last months and sometimes longer than a year. They lack a third party, such as a court or administrative law judge, to oversee the process and adjudicate disputes. Companies also forfeit their attorney-client privilege during examinations. With these considerations in mind, Congress carefully defined the CFPB's supervisory authority by generally limiting supervision to larger banks and larger non-banks who can bear the high cost of complying with examinations and also mandating requirements before the Bureau can expand the scope of its authority through larger-participant rulemaking.

My testimony will focus on three issues relating to the Proposed Rule:

1. the rulemaking requirements in the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act");

2. duplication with existing supervision by federal prudential regulators and state agencies; and

3. the low transaction volume threshold.

I. Applicable Statutory Rulemaking Requirements

Defining the Market Covered by the Proposed Rule

The Dodd-Frank Act authorizes the Bureau to supervise "larger participant[s] of a market for . . . consumer financial products or services."[1] Before issuing a larger-participant rule, the Bureau must consult with the Federal Trade Commission ("FTC").[2] That requirement is critical because defining a "market" is the fundamental prerequisite to determining who is a larger participant within the defined market.[3] The FTC analyzes market concentration and enforces federal antitrust laws.

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[1] 12 U.S.C. § 5514(a)(1)(B).

[2] 12 U.S.C. § 5514(a)(2).

[3] Although the term "market" is not defined, *see* 12 U.S.C. § 5481, other text within the Dodd-Frank Act suggests that the term "market" must be read by reference to the applicable *product, see id.* § 5514 ("The Bureau shall exercise its authority under paragraph (1) in a manner designed to ensure that such exercise, with respect to persons described in subsection (a)(1), is based on the assessment by the Bureau of the risks posed to consumers in the *relevant product* markets and geographic markets . . . .") (emphasis added).

And therefore, the Dodd-Frank Act requires the CFPB to consult with the FTC to get its input regarding the market to be defined in the rulemaking and the larger participants in the market.

In response to the requirement to consult with the FTC, the Proposed Rule states that the CFPB "consulted with *or provided an opportunity for consultation and input*" to the FTC and other federal agencies.[4] Moreover, the Proposed Rule neither discusses any input from the FTC, nor the factors determining which products and services should be included within the same payments market.[5] It is therefore unclear whether the Bureau met its statutory obligation to consult with the FTC, which plainly provides that the Bureau "shall consult" with its sister agency.[6]

The collaborative process to define a market appropriate for larger-participant rulemaking is especially important for the consumer payments ecosystem because of the diversity of companies operating in this space. Companies in the payments ecosystem have different risk profiles depending on where their products or services are situated in the payments ecosystem.

Without the essential market-defining analysis, the Proposed Rule concludes that "general-use digital consumer payment applications" is a single market. For example, companies offering digital applications for person-to-person ("P2P") transfers are fundamentally different from companies that process payments for merchants. Yet both types of companies fall under the Proposed Rule. Another example is the Proposed Rule's inclusion of both "funds transfer functionality" and "wallet functionality" within the definition of "covered payment functionality."[7] The Proposed Rule "treat[s] these two covered payment functionalities as part of a single market for general-use digital consumer payment applications" even though the Bureau concedes that the "technological and commercial processes these two payment functionalities use to facilitate consumer payments may differ in some ways."[8] The overbroad market definition potentially conflates companies as disparate as (1) a company that allows consumers to make payments using a stored balance held by that company; (2) a company that routes funds from a consumer's bank account for transmission to a third party; (3) a company that offers payment methods to facilitate the purchase of goods and services from merchants, which is generally exempt from regulated money transmission under federal and state laws because of the minimal risk posed to consumers; and (4) a company that merely holds and passes payment information, such as card numbers, but never participates in the flow of funds from the consumer to the third-party recipient.

This one-size-fits-all approach deviates from history and the CFPB's earlier larger-participant rules. Federal and state laws have been tailored to different types of consumer financial products,

[4] 88 Fed. Reg. at 80199 (emphasis added).

[5] *Id.*

[6] 12 U.S.C. § 5514(a)(2).

[7] 88 Fed. Reg. at 80204.

[8] *Id.* at 80204-80205.

such as small-dollar loans, installment loans, student loan servicing, mortgage lending, mortgage servicing, and open-end lines of credit. The Dodd-Frank Act, and the Bureau's other larger-participant rules, have followed that precedent. The Bureau's Remittance Transfer Rule, for example, focuses on international money transfers and the risks to consumers specific to that industry. It does not attempt to capture domestic money transfers, which is an entirely different market. The Proposed Rule deviates from that well-established approach, and instead, conflates distinct markets.

Inadequate Cost-Benefit Analysis

The Bureau has a statutory obligation to properly analyze the costs and benefits of a rule before promulgating it. Under the Dodd-Frank Act, the Bureau must consider "the potential benefits and costs to consumers and covered persons, including the potential reduction of access by consumers to consumer financial products or services resulting from such rule."[9] Generally, "reasoned decisionmaking" demands "consideration of [all] the relevant factors" underlying agency action,[10] and "an agency may not 'entirely fai[l] to consider an important aspect of the problem.'"[11] It follows that an agency typically must "pay[] attention to the advantages *and* the disadvantages of its decisions."[12] Thus, "cost-benefit analysis is a central part of the administrative process."[13]

An agency violates its cost-benefit-analysis obligations when it "opportunistically frame[s] the costs and benefits of [a] rule; ... neglect[s] to support its predictive judgments; [and] contradict[s] itself."[14] Uncertainty "does not excuse the [agency] from its statutory obligation . . . to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure."[15]

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[9] 12 U.S.C. § 5512(b)(2)(A)(i).

[10] *MetLife, Inc.*, 177 F. Supp. 3d at 230 (alteration in original) (quoting *Michigan*, 135 S. Ct. at 2706).

[11] *Michigan*, 135 S. Ct. at 2707 (alteration in original) (quoting *Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co.,* 463 U.S. 29, 43 (1983)).

[12] *Id.* at 2707 (alteration in original).

[13] *MetLife, Inc.*, 177 F. Supp. 3d at 240.

[14] *Bus. Roundtable v. SEC,* 647 F.3d 1144, 1148-49 (D.C. Cir. 2011).

[15] *Chamber of Comm. of the U.S. of Am. v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005).

A critical step in the cost-benefit analysis is identifying and assessing the potential risk to consumers.[16] But the Proposed Rule does not satisfy this important requirement.[17]

II. Duplication With Supervision By State and Other Federal Regulators

The Proposed Rule states that it will "level the playing field between nonbanks and depository institutions, which the CFPB regularly supervises and which also provide general-use digital consumer payment applications."[18] The Bureau also notes in the Proposed Rule that states have supervisory programs related to money transfers, but "there is no Federal program for supervision of nonbank covered persons in the market for general-use digital consumer payment applications with respect to Federal consumer financial law compliance."[19]

Those statements ignore the host of companies partnering with financial institutions, who would be covered under the Proposed Rule, but are already subject to examinations by the CFPB or the banks' prudential regulators under the Bank Service Company Act.[20]

On May 16, 2012, the CFPB and the prudential regulators entered into a Memorandum of Understanding ("MOU").[21] The MOU's objectives include minimizing "unnecessary regulatory burden" on covered financial institutions, avoiding "unnecessary duplication of effort," and ensuring that the CFPB and the prudential regulators "effectively and efficiently carry out their respective responsibilities."[22] Many aspects of the Proposed Rule contradict the MOU. The companies who partner with financial institutions already subject to CFPB or prudential-regulator oversight would be subjected to duplicative supervision because of the Proposed Rule.

Many companies covered by the Proposed Rule are currently supervised by multiple states under various laws covering money transmission, loan brokering or origination, loan servicing, and debt collection. Notably, the Proposed Rule glosses over the robust state and federal supervision over money transmitters.[23] State laws and federal regulations have carefully assessed which activities

[16] 12 U.S.C. § 5514(b)(2)(C).

[17] 88 Fed. Reg. at 80200 n.24 (second and third alterations in original) (emphasis added).

[18] *Id.* at 80201.

[19] *Id.* at 80211.

[20] 12 U.S.C. § 1867.

[21] Memorandum of Understanding on Supervisory Coordination (May 16, 2012), https://files.consumerfinance.gov/f/201206_CFPB_MOU_Supervisory_Coordination.pdf.

[22] *Id.* at 2.

[23] Federal law defines "money transmission services" as (A) "the acceptance of currency, funds, or other value that substitutes for currency from one person and the transmission of currency, funds, or other value that substitutes for currency to another location or person by any means. 'Any means' includes, but is not limited to, through a financial agency or institution; a Federal Reserve Bank or other facility of one

require licensing and supervision in connection with transmitting money.[24] And, in recent years, a growing number of states are modernizing their laws in this area by enacting the Model Money Transmission Modernization Act. The Proposed Rule does not mention how the Bureau intends to address the existing federal and state oversight over certain payments-related activities or the overlapping examinations focusing on the same subject matter that will happen under the Proposed Rule. It also fails to address how the CFPB's examinations will add value beyond the examinations already being conducted by the federal prudential regulators and the states, while downplaying the significant additional costs resulting from the duplication.

III. Transaction Threshold

The Proposed Rule sets the transaction threshold to qualify as a larger participant in the payments ecosystem at a mere five million consumer payment transactions per year.[25] The Proposed Rule does not explain why transaction volume alone, without considering other variables such as dollar amounts, payment type, etc., should define the scope of CFPB's supervisory authority relating to payments. The Proposed Rule also does not adequately address why it ultimately settles on five million transactions as the threshold, especially when the CFPB estimates that at least 190 companies may be subject to the Proposed Rule.[26] With this low threshold, many smaller to mid-size companies will fall under the "larger" participant classification.

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Thank you again for the opportunity to participate today. I look forward to addressing any questions you may have.

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or more Federal Reserve Banks, the Board of Governors of the Federal Reserve System, or both; an electronic funds transfer network; or an informal value transfer system; or (B) Any other person engaged in the transfer of funds." 31 C.F.R. § 1010.100(ff)(5)(i).

[24] For example, many states have decided not to supervise companies that meet the agent of the payee exemption due to the low risks that these companies pose. Similarly, under federal law, the definition of "money transmission services" contains exclusions, including, but not limited to, an exclusion for payment processors in addition to an exclusion for companies that "[a]ccept[] and transmit[] funds only integral to the sale of goods or the provision of services, other than money transmission services, by the person who is accepting and transmitting the funds." 31 C.F.R. § 1010.100(ff)(5)(ii)(F).

[25] 88 Fed. Reg. at 80210, 80214.

[26] *Id.* at 80210 n.88.