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Clearing a Path for Fintechs to Navigate Through the State Licensing

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As can be attested to by many, including many fintechs, the various government units in the United States can be somewhat effective in legislating and regulating problems that are identifiable and have existed for some period of time. However, it is virtually impossible for the government units to legislate or regulate in anticipation of the disruptive technologies that have been developed through the years including the technology developed by the various fintechs. No one's crystal ball is that good.

As technology has developed over the past several years, various regulators have begun evaluating the business models of fintech "money services businesses" and concluding that maybe, just maybe, the fintech MSBs fall within the scope of the regulator's jurisdiction. As such, the fintech MSBs have been scrambling to determine: (1) if they are, indeed, subject to regulation, including the requirement to be licensed; (2) if so, which government entity (or entities) has jurisdiction to regulate and license the fintech MSBs and (3) how can the fintech MSBs comply with the regulations, including obtaining applicable licenses, in an efficient, cost-effective manner.

Historical Perspective

The initial issues faced by the fintech MSBs include whether the business model is subject to regulation and which government unit (or level of government) has jurisdiction to regulate and license their business. Traditional, non-bank MSB's are one of the lines of business in which the federal government has historically abstained from regulating. As a consequence, the individual states stepped in to fill the void.

Prior to the development of the Internet and further disruption by online fintechs, the state-by-state patchwork of regulations was adequate to address the competing interests of the MSBs physically located in a state and its customers located in that state. Now consumers in every state have the ability to consider MSB products from not only MSBs that have a physical location in their state, but also fintech MSBs that merely have virtual presence in their state. This practical reality requires the fintech MSBs to become licensed in multiple states, an obligation that can be very burdensome.

As was recently noted by the Washington State Department of Financial Institutions, "Generally speaking, MSBs have to apply for a license in each state in which they want to offer their services. As technology in the financial services area has advanced, state regulators have heard complaints from innovative startups providing money services about the difficulties of varying licensing requirements in multiple states and challenges of having their full application reviewed separately by each individual state before they can offer their services nationwide."[1]

Regulatory Turf War

In 2016, the federal government through the Office of the Comptroller of the Currency (OCC) attempted to take control of fintech regulation and initiated a dialogue about "special purpose" national bank charter.[2] The idea would allow the OCC to license, regulate and supervise various types of fintechs including those that provide MSB services and market place lending services, and the licensees would be exempt from state licensing laws.

The response from the states to the concept of a "special purpose" national bank charter was overwhelmingly negative. In general terms, several states objected to the OCC's proposal as exceeding its authority under the National Bank Act and usurping the state's powers to regulate MSBs, even those fintechs operating in multiple states. Indeed, the state of New York filed a lawsuit seeking to enjoin the OCC from issuing the regulations that would have allowed it to issue "special purpose" national bank charters.[3]

Beginnings of a State Solution

Even though the OCC's "special purpose" national bank charter is still being discussed, several states have responded to the multistate regulatory and licensing issues, at least in part. On February 6, 2018, the banking regulators for seven states (Georgia, Illinois, Kansas, Massachusetts, Tennessee, Texas and Washington) announced through the Conference of State Bank Supervisors (CSBS) a joint licensing program that will hopefully begin clearing a path for fintechs to navigate through the state licensing process.[4] It should be noted that the joint licensing program only applies to "money service businesses," which, for example, was defined by the Texas Department of Banking as "money transmitters, payment companies payments confirming and companies that store value of mobiles among others."[5]

Under the compact, if one state reviews key elements of state licenses for MSB (such as cyber security, business plan, background check and compliance with the Federal Bank Secrecy Act), then the other participating states agree to accept the findings.

Is the Compact a Meaningful Solution?

While the compact is a step in the right direction to provide fintech MSBs with a streamlined process, it is only that – a step and only a step relating to licensing. In order for the process to be truly meaningful, the states will need to consider coordinating their efforts in legislating uniform laws relating to MSBs and to coordinate or streamline the examination process such that the regulated MSBs are subject to only one set of examinations as opposed to examinations in each state. The CSBS is optimistic that the recently announced compact signals a movement towards an integrated, 50-state system of licensing and supervision of fintechs.[6] If that is indeed the case, such a process will provide welcome relief from duplicative regulatory burden for fintechs and provide the possibility that consumers will have access to a greater choice of MSB products to meet their needs.

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[1]Press Release, Washington State Department of Financial Institutions, Washington DFI Leads Effort to Streamline Multi-State Licensing for Money Service Businesses (Feb. 6, 2018).

[2]Office of the Comptroller of the Currency, Exploring Special Purpose National Bank Charters for Fintech Companies (December 2016).

[3]Vullo v. Office of the Comptroller of the Currency, et. al., Case No. 17-cv-03574 (S.D.N.Y. May 12, 2017).

[4]Press Release, Conference of State Bank Supervisors, State Regulators Take First Step to Standardize Licensing Practices for Fintech Payments (Feb. 6, 2018).

[5]Press Release, Texas Department of Banking, Texas Announces Enhanced Licensing Processes for Money Service Businesses (Feb. 6, 2018).

[6]See Press Release, Conference of State Bank Supervisors, supra note 4.