



# *Financial Services Management*

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## **Fintech Innovation and Expansion**

### **Cite**

CFPB, Policy Guidance, Policy Statement on No-Action Letters, Policy guidance and procedural rule, Policy on the Compliance Assistance Sandbox

### **Recommended Distribution:**

Consumer Finance, Fintech, Corporate Planning, Policy, Compliance, Risk Management, Legal, Government Relations

### **Website:**

<https://www.govinfo.gov/content/pkg/FR-2019-09-13/pdf/2019-19763.pdf>; <https://www.govinfo.gov/content/pkg/FR-2019-09-13/pdf/2019-19762.pdf>

## **Impact Assessment**

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- A clear pathway has been established for regulatory certainty with regard to consumer-protection regulations governing certain consumer fintech offerings.
- AML and bank safety-and-soundness hurdles remain.

## **Overview**

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The CFPB has finalized new policies that lay out when companies are likely to receive no-action letters (NALs) that smooth the path for new product offerings and/or authorize “sandboxes” to ensure that such ventures are fully compliant with CFPB expectations under consumer-protection law and rule. However, the new NAL framework does not apply solely to technology or otherwise innovative products, also providing scope for innovation in existing and established consumer-finance products that may tread on or perhaps even be seen to violate federal standards. Even so, these NALs and the new sandbox program do not eliminate potential liability for all providers deemed by federal or state authorities to pose anti-money laundering (AML) or similar risk nor do they ensure that state or federal banking agencies will sign off on new products from a safety-and-soundness perspective regardless of the Bureau’s conclusions about consumer protection. As a result, nonbanks are likely to have the least difficulty taking advantage of the CFPB’s new opportunities, although even they are likely to face obstacles in states where attorneys general or other authorities believe an activity violates state consumer-protection law or rule.

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## Impact

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Both of these new policies are predicated on the CFPB's belief that financial-technology innovation offers an array of consumer and financial-market benefits that warrant removal of impediments to product offerings. Although the policy statements reference "safety and security" among the benefits likely from financial innovation, the Bureau's approach is nonetheless markedly different than that of the federal banking agencies. While the OCC's new special-purpose fintech charter<sup>1</sup> does provide for significant variance from the OCC's prudential standards, the agency appears in practice reluctant to provide significant flexibility. Similarly, the FDIC has been wary of chartering industrial loan companies (ILCs) or other "nonbank bank" charters for nonbank fintech providers in part due to concerns about safety-and-soundness risk. The Federal Reserve is even more chary of fintech, reinforcing the federal bank-regulatory focus on bank safety in contrast to potential consumer benefit resulting from fintech innovation.

Traditional insured depositories and their holding companies must first and foremost consider what their federal and state prudential regulators will accept in terms of fintech or other product innovation. As a result, it may prove difficult for established banking organizations to take advantage of the CFPB's opportunities.

Another challenge not just for banks but also across the spectrum of consumer-finance products is AML risk. This generally falls under the banking agencies for covered organizations in concert with standards across the spectrum of financial institutions from the Treasury Department's FinCEN, which both sets rules and takes enforcement actions. State regulators and law-enforcement authorities are also keenly aware of AML risk. Nothing in the CFPB's policy frees companies from potential AML-compliance risk. As a result, products taking advantage of them are likely at least as first not only to come from nonbanks, but also to be those deemed very unlikely to be problematic from an AML perspective.

The NAL policy retracts 2016 CFPB standards that laid out an approval process even as the agency made clear that no-action letters would be rarely, if ever, granted. The agency now believes that NALs should be liberally granted to spark innovation, rejecting consumer-advocacy group comments on its initial proposal and those from some state attorneys general that doing so will put consumers at undue risk.

Some state attorneys general were also wary of the proposal on grounds that CFPB authority might well approve products that they felt posed risks to their own consumers or were potentially violations of state law due to the benefits of federal preemption. As detailed below, the NAL policy now makes it clear that letters will not provide recipients with sufficient comfort on which to claim federal preemption even though this may in fact apply based on the preponderance of facts germane to individual offerings.

The compliance-assistance policy follows a 2018 proposal to free fintech companies to experiment with new financial products in "sandboxes" without, it is hoped, also immediately threatening vulnerable consumers. Recasting the proposed sandbox construct into the new compliance-assistance sandbox (CAS) policy, the CFPB has opened an avenue to fintech innovation with numerous controls that limit the scope of innovation within somewhat narrower boundaries than initially proposed. As a result, this new approach does not provide the wide-open field for innovation advocates hoped, but it also does not expose consumers to the harm some feared. Risks are further limited because state attorneys general may intervene when they believe activities in a sandbox violate state law.

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<sup>1</sup> See **FINTECH20**, *Financial Services Management*, August 3, 2018.

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The final CAS policy also includes a lengthy defense of the Bureau's authority under the Administrative Procedure Act to grant these sandboxes. It remains to be seen if consumer groups and dissenting state attorneys general concur. If they do not, then firms receiving sandbox approval may find themselves caught in protracted procedural legal disputes or litigation. Although seven state attorneys general joined a new coordination group the Bureau announced in concert with these new policies, none of them have committed to accept Bureau NALs or sandbox approval as compliance with state standards.

## What's Next

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Both policies were issued on September 10. Each is also effective as of September 10. However, the policies also fall under the Congressional Review Act and thus have been submitted to the Congress and GAO for possible rejection.

The final policies also indicate that the agency plans to propose a new framework for issuing interpretive letters and for providing sandbox-related exemptions by regulatory order. No timing for doing so is noted.

## Analysis

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### A. No-Action Letter Policy

This policy lays out the CFPB's rationale for issuing NALs to fintech innovators (e.g., increasing their ability to attract outside investors). It is generally short and does not detail specific NAL submission or approval criteria because the agency believes that fintech is sufficiently novel as to warrant maximum flexibility. The final policy makes it clear that NALs may be modified or revoked, rejecting comments arguing that NALs permanently protected companies from effective enforcement. The final statement also emphasizes that NALs only cover those to whom they are granted; other market participants must adhere to otherwise-applicable rules unless or until the Bureau crafts a broadly-applicable policy or they receive their own NAL.

Other aspects of the NAL policy include:

- a streamlined application process;
- a statement that NALs will generally be for unlimited durations;
- an expectation that NAL recipients will advise the Bureau of material problems or risks;
- clarification that NAL approval does not constitute CFPB approval of the product or provider;
- streamlined assessment criteria including a sixty-day review period to give applicants certainty of agency action;
- a description of likely letter content providing limited liability protection and other agency conclusions;
- expectation that NALs will include statements that the opinion is not an agency interpretation of law or rule. As a result, the question of federal preemption will be decided on a case-by-case basis; and

- alternative procedures for trade associations, service providers, and others that may not be directly under CFPB authority. This provides for “template” approval followed by a more detailed process prior to formal issuance of an NAL to individual providers of a covered product or service. Alternative, more rapid NALs may also be granted to applicants proposing only minor variations in an activity already covered by an existing NAL.

## ***B. Compliance-Assistance Sandbox Policy***

The final version emphasizes that sandboxes do not provide regulatory “relief,” but rather guidance as to how the CFPB believes entities should act to ensure compliance with existing requirements under its authority. The final policy no longer includes the proposed statutory or regulatory exemptions by CFPB order. As noted, a separate rulemaking will address the question of regulatory exemptions by CFPB order. However, the final policy reasserts the Bureau’s authority to preempt state law by action under this program, describing key statutory provisions and how they will be addressed by this policy. As noted, the CFPB’s safe harbor would apply to specific provisions of the statutes cited for safe harbors but does not necessarily insulate a regulated banking organization from liability under the safety-and-soundness enforcement authority vested in federal or state bank regulators or from AML-compliance risk.

Key aspects of this policy include:

- an expectation that sandbox approvals will be time-limited and extend no longer than two years. Successful projects would lead to express changes in CFPB rule or commentary that then opens the experimental project for widespread adoption as well as expansion by the entity receiving sandbox approval;
- a streamlined review and approval process along with a process through which firms can request modifications to prior approvals;
- an approval-termination process;
- a “template” approval process for third parties such as trade associations or service companies. The template is “non-operative” – i.e., a company wishing to provide services pursuant to it would still need to file its own CAS application. However, third parties could provide a service covered by another CAS approval to another party;
- no express exemptions from current law or policy as proposed. Instead, the CFPB plans to propose a legislative rule providing for the issuance by order of regulatory or other exemptions. This is in addition to the pending proposal to create the interpretive-letter program described above. Interpretive rules will continue to be issued as the agency desires;
- a sixty-day review period along with a pre-approval process;
- public disclosure of certain terms, conditions, and other aspects of sandbox approvals and denials. In general, the only information that will be redacted is that covered by the Freedom of Information Act;
- a clear statement that offerings approved under state-sanctioned sandboxes may not necessarily gain CFPB approval; and
- a commitment to coordinate with other authorities to the extent practicable. Applicants that request this coordination are told that they may encounter approval delays.