US FINTECH REGULATION

HOW THE US REGULATORY ENVIRONMENT IS HOLDING BACK THE FINTECH INDUSTRY AND WHY REGULATORS NEED TO ACT NOW

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KEY POINTS

- **Global financial regulation ballooned after the 2008 financial crash.** In fact, the number of regulatory publications, changes, and announcements increased 492% between 2008 and 2015. This came on top of already extensive regulation and oversight governing the financial services sector, as regulators looked to increase consumer protection and prevent such an event from occurring again.

- **Heavy regulation can hinder innovation, and this issue is exacerbated in the US by the existing regulatory framework.** The country's regulatory system involves many different players at the federal level, as well as a regulator for each state. Each regulator also covers different jurisdictions and issues different rules and requirements for financial firms. This complexity not only makes the US regulatory environment harder for fintechs to navigate in the first place, but it's a major barrier to the development of a coherent fintech policy.

- **Fintechs are using different models to achieve compliance — but none are ideal.** Some partner with legacy institutions to piggyback off their licenses, which introduces complexity to business models, typically requires that fintechs share their revenue with partners, and leads to uncertainty over which firm bears the compliance burden. Other fintechs choose to operate independently, but they must decide which states to launch in first, as very few fintechs can afford to acquire the licenses necessary to deploy nationwide.

- **Meanwhile, the US is notably behind when it comes to establishing a coherent policy on fintech.** Although the country arguably maintains a global lead when it comes to the size of its fintech industry, there are several segments where the UK and Europe are pulling ahead. These regions have acted by introducing special frameworks and rules for fintechs, while none of the US regulators have formed a policy — let alone reached a cross-agency consensus.

- **Some US regulators realize the benefits fintechs offer and have implemented initiatives to make compliance easier.** Major regulators including the OCC, CFPB, and SEC have launched initiatives designed to help them better understand the risks and opportunities of fintech, and what that means for existing regulatory regimes. Several have hinted they may alter regulation as a result.

- **But a supportive regulatory environment for US fintechs is still a long way off.** These initiatives vary widely and have little overlap with each other, which means it's unlikely that a specific and thorough regulatory framework will emerge anytime soon. It's more likely that each regulator will work to establish guidelines to make it easier for fintechs to understand the regulatory requirements that apply to them. Further out, any sector-wide regulatory framework will likely focus on innovative firms that don't fit into existing regulation.

- **The Trump Administration may have an impact on the US fintech industry, but the full implications aren't yet clear.** It will take time for the new president to establish himself and clarify policies, and most agencies are likely to remain in information-gathering mode as his positions grow apparent. Longer term, legacy players could become better placed to compete with fintechs due to a decreased regulatory burden.

Download the charts and associated data in Excel »

INTRODUCTION

After the 2008 crash, the already heavily regulated global financial services industry experienced a crackdown, with regulators implementing rules and legislation designed to increase consumer protection and prevent such an event from occurring again. In fact, the number of regulatory publications, changes, and announcements increased 492% between 2008 and 2015. But heavy regulation can have a negative side effect — a hindering of innovation in the industry. In turn, this can stifle the development of a thriving fintech sector.

In the US, this issue is exacerbated by the way financial regulation is constructed and enforced. There are at least 12 federal financial regulators and organizations, each of which has its own remit. And on top of that, each state has its own regulators with powers to make their own judgments and implement their own rules. This means startups must find ways to fit their business models into highly complex existing regulatory frameworks designed for incumbents — without the resources available to legacy players.

The US also still hasn't decided if it even wants a comprehensive framework that promotes the growth of fintech. While regulators in the UK, Singapore, and Australia have already implemented regimes designed to make compliance easier for fintechs and encourage the growth of the industry, US regulators are still in fact-finding mode. Each is trying to determine what kind of fintech-specific regulation may be warranted or necessary, and even after they're done, the fact there are many of them will likely hinder the creation of a coherent, supportive regulatory regime, the likes of which we have seen elsewhere.

In the meantime, US fintechs face a significant hurdle as they navigate the regulatory environment, struggling to decipher which rules apply to their business models and, once that's achieved, how to ensure they're compliant. Lacking the resources of incumbents, fintechs typically have no choice but to partner with third parties or take a state-by-state approach, hoping they can remain within the law with meager compliance resources. Both of these approaches negatively impact fintechs' ability to scale — which is key to their success.

This report examines the current regulatory landscape in the US and how it's impacting the fintech industry. In addition, it discusses the methods fintechs are using to meet regulations as best they can, and details the fintech-specific initiatives that have already been launched by regulators and their likelihood of success. It also considers the future of fintech regulation in the US and how it may shape the fintech sector long term.

US FINANCIAL REGULATORY LANDSCAPE

The current US regulatory landscape has several key characteristics that make it more difficult for fintechs to navigate than those of the UK or the EU. These characteristics also make the establishment of coherent policy for fintech nearly impossible.

The US has at least 12 different regulatory bodies. Each agency has a different remit and can make its own rules and regulations. Firms subject to that regulation, however, often fall under the jurisdiction of more than one agency, which can make achieving compliance a highly complex undertaking. The OCC regulates banks, while the SEC handles securities and exchanges, but the CFPB handles consumer protection. This means that while a firm may fall under either the SEC or the OCC, it will almost always have to adhere to the CFPB's rules as well. In comparison, the EU has a centralized legislative body, the European Commission, which answers to the European Parliament. As a result, the same rules apply in all EU member states.

MAJOR US FINANCIAL REGULATORS AND ORGANIZATIONS

Prudential Bank Regulators	Securities and Derivatives Regulators	Other Regulators	Coordinating Forum
Office of the Comptroller of the Currency (OCC)	Securities and Exchange Commission (SEC)	Federal Housing Finance Agency (FHFA)	Financial Stability Oversight Council (FSOC)
Federal Deposit Insurance Corporation (FDIC)	Commodities Futures Trading Commission (CFTC)	Consumer Financial Protection Bureau (CFPB)	Federal Financial Institutions Examinations Council (FFIEC)
National Credit Union Administration (NCUA)	Financial Industry Regulatory Authority (FINRA)	Financial Crimes Enforcement Network (FINCEN) (Department of the US Treasury)	President's Working Group on Capital Markets (PWG)
Federal Reserve Board (the Fed/FRB)			

BI INTELLIGENCE Source: The Congressional Research Service

Each US state has its own regulatory agency. This means that firms often have to acquire licenses in each state they wish to operate in, which is expensive and can be complicated. As a result, many fintechs find it hard achieve the scale they need for their business models to work. In some instances, such as banking, a federal license exists that allows firms to operate nationally; however, the requirements of such licenses, including obtaining expensive Federal Deposit Insurance, are often beyond the resources of most startups. In contrast, the EU allows firms to hold "passports," which means that once they are licensed in one member state, they don't need to go through further authorization in other states. So once a fintech is licensed in one EU member state, it has a potential addressable market of over 700 million.

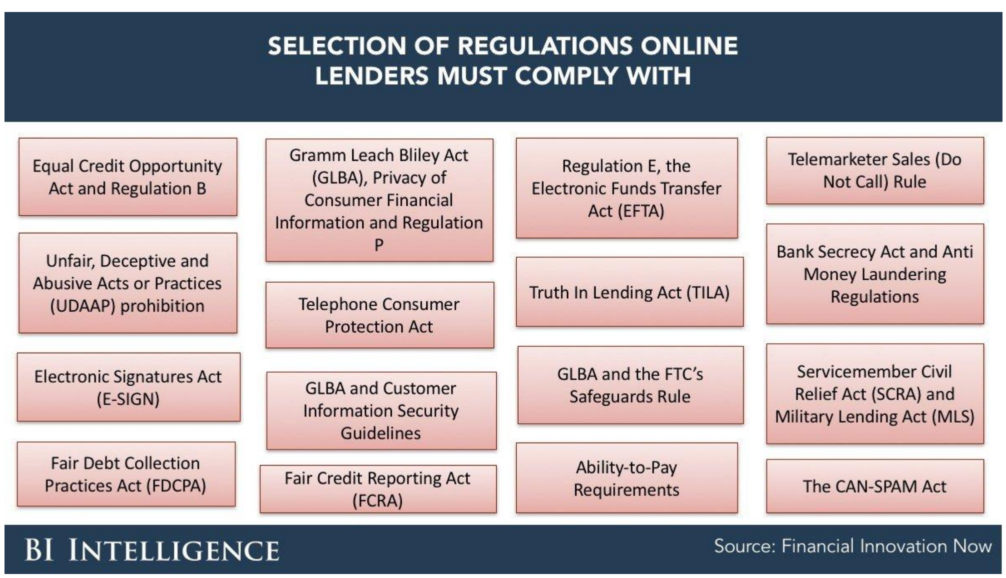
Regulation is rules-based rather than principle-based. US regulation is largely rules-based, affording it a lot less flexibility than the principle-based regulatory frameworks of the EU and UK. Rules-based regulation dictates what can and cannot be done, while principle-based regulation requires adherents to prove they meet specific principles. For example, under a rules-based framework, a regulator might dictate that a firm has specific software in place to ensure customer data is protected, while in a principle-based framework, the regulator would ask the firm to prove that customer data is safe. Meanwhile, for regulation to be changed in the US, it has to go through Congress, which is a time-consuming process. Regulation in the UK and EU also has to be approved by parliamentary bodies, but because it is principle-based, it needs to be changed less often. In addition, regulators find it easier to adapt their policies to keep up with innovation without the need to go through the legislature.

AREAS OF FINTECH AND MODELS OF ACHIEVING COMPLIANCE

Fintechs in different segments are using a variety of models to navigate the US regulatory landscape. These models are evolving over time as firms work out how best to achieve compliance in the cheapest and most efficient manner. That said, none yet seems ideal.

Alternative lenders. Most marketplace lenders rely on partner banks to underwrite their loans, saving them the effort of getting licensed to do so themselves. But they're still limited as to which states they can operate in based on rules surrounding retail investors. These rules typically limit the amount individuals can invest based on their net worth or some other assessment of their overall financial status. In some states, these rules are so stringent that it's not worth marketplace lenders attempting to enter the market. Partnership with a bank also makes lenders subject to examination by the OCC and FDIC because they become third-party suppliers.

Other types of lenders are typically licensed on a state-by-state basis under existing lending laws. Due to differences in state laws, firms may have to adapt their products to meet individual state requirements, around interest rates, for example. They might also find it hard to work out which rules apply in which states without the extensive compliance teams of their larger competitors — LendUp found this out the hard way after it was fined for breaking laws specific to California.



Insurtechs. Most insurtechs operate as enablers for legacy insurers by providing them with ways to improve their end products or services, or by offering new distribution channels. In many cases, this requires insurtechs be licensed as insurance brokers in each state they wish to operate in. A few insurtechs tout their own end-to-end products, however, and this requires them to have multiple licenses in each state. It's notable that the firms taking this route, like home insurer Lemonade and health insurer Oscar, have significant funding behind them. This suggests that it's only insurtechs with large resources available that can afford to get their own insurance licenses, likely because of high minimum capitalization requirements. These examples are also only authorized in a few states — Lemonade is only operational in New York, while Oscar is live in New York, California, and Texas. Meanwhile, other insurtechs operate on a hybrid model — auto-insurer Metromile, for example, underwrites its own insurance in some states, while relying on a partner insurer in others. This model may add complexity and expense to firms' operations.

Digital-only banks. Nearly all US digital-only banks are subsidiaries of legacy institutions or have partnerships with existing banks because the barriers to getting a charter, which includes the need for Federal Deposit Insurance, are very high. For example, Ally Bank started out as the banking subsidiary of General Motors Acceptance Corporation (now Ally Financial), Simple Bank had a partnership with the Bancorp before it was acquired by BBVA, and Moven's cards are issued by CBW bank. A charter is a license that allows an organization to accept deposits and lend out money. In the US, they can either be obtained on state-by-state basis, or federally. The latter option is typically a more complex process and can be expensive, thanks to all the processes required and the volume of supporting information needed to submit an application.

Payments fintechs. Most payments fintechs hold a money transmitter license that must be applied for in each state in which they wish to operate. Barriers to obtaining these licenses are relatively low, which has helped payments fintechs proliferate. Firms using them include remittance firms like Xoom, mobile payments company and processor Square, and many cryptocurrency companies. Payments firms can also avoid expensive anti-money laundering disclosure requirements by limiting the value of transfers to under $10,000.

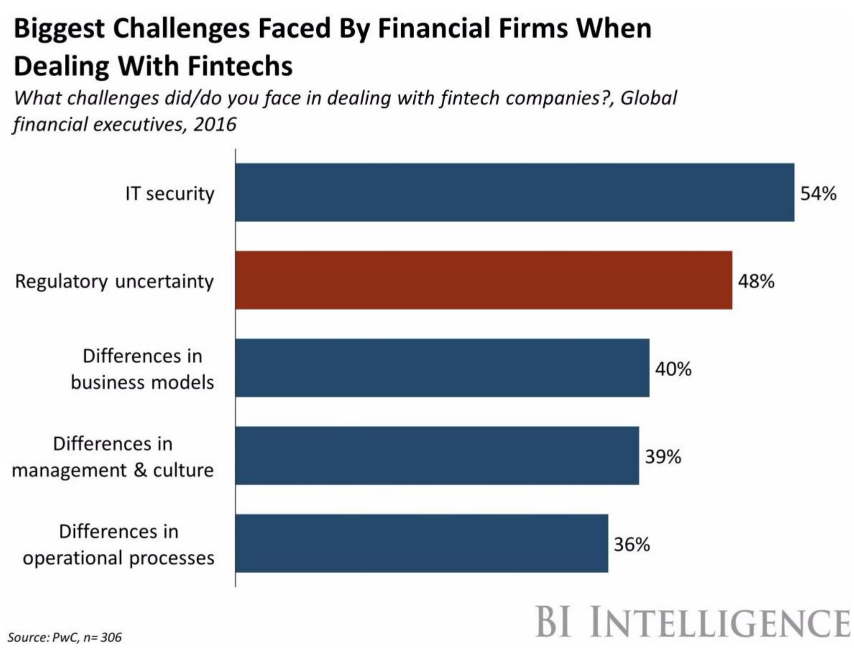
A potential hurdle payments fintechs face relates to the CFPB's recent prepaid card regulation, which requires upfront fee disclosure, elimination of overdraft fees, better fraud and loss protection, and more stringent requirements for lines of credit. These regulations apply not only to firms issuing prepaid cards, but also to any company that stores value — which includes P2P payment apps like Venmo. That said, many of these firms are already well placed to comply with these rules, so they shouldn't find it too onerous to meet the CFPB's requirements.

Virtual currency firms. New York has a specific license for virtual currency firms, while in North Carolina they are explicitly covered by money transmitter regulations. Outside of these two states, the situation is much less clear, with many firms in a no-mans land and in constant fear that lawmakers might decide to introduce crytpocurrency-specific legislation that may hinder their operations. This fear is exacerbated by the connection many legislators continue to make between bitcoin and illegal activity.

Additional Considerations For US Fintechs

Nearly all fintechs have to abide by Anti-Money Laundering (AML) regulations. This is particularly true for any firm that is classified as a Money Services Business (MSB), a firm that converts or transmits money. MSBs are subject to the Bank Secrecy Act (BSA) and therefore required to register with the Treasury, have a written AML compliance plan, file records for transactions over $10,000, and formally report any suspicious activity. Penalties for failing to comply can be heavy — blockchain-based, cross-border payments company Ripple was fined $700,000 for noncompliance in May 2015. Online lenders also have reason to be vigilant regarding AML laws after the San Bernardino shooter was widely reported to have borrowed money from marketplace lender Prosper.

The partnership model could be troublesome for fintechs. This is because it introduces complexity to business models that can negatively affect end consumers and typically requires that fintechs hand over a share of revenue to their partners. In addition, it can result in uncertainty over which party is responsible if any law is found to be broken. Legacy players can also be reluctant to work with fintechs where the path to compliance is not clear.



Areas Where US Regulation Is Falling Short

Although the US arguably maintains a global lead when it comes to the size of its fintech industry, there are several segments where the UK and Europe are pulling ahead, thanks to their more advanced fintech regulation.

Marketplace lending. Unlike in the UK, where lenders must obtain a special license issued by the Financial Conduct Authority (FCA), the US has no marketplace-lending-specific regulation. And while the US industry has achieved significant size due to the lower compliance burden, it has also seen a major scandal at one of the biggest lenders, which has not occurred in the UK. The result of that scandal was a contraction of the marketplace lending industry as lenders struggled to attract capital and originate loan volumes, with several firms forced to abandon plans for expansion or cut staff. The UK industry, meanwhile, has seen only the consolidation expected of a new industry as dominant players emerge and smaller firms fail to establish themselves, with the largest platforms, notably Funding Circle, continuing to look healthy.

Challenger banks. As mentioned, there are very few true challenger banks in the US, or ones that are not subsidiaries of larger organizations, because meeting the requirements to obtain a federal license is still beyond most startups. Some may be able to obtain state licenses, but this would restrict their operations to that particular state, which would likely not provide a large enough market for success. However, in the UK, where new banks can obtain a tailored national charter with lower capital requirements, digitally focused challengers have proliferated. This is also true in the EU to a certain extent, where regulations allow for a firm to be licensed in one country and operate in any other member state, affording them a large enough addressable market to survive.

Insurtech. Insurtechs first came to prominence in the US, due largely to the dominance of the country's insurance industry, which is the largest in the world. However, the complex regulatory environment for firms in this space has since seen an increasing number of insurtechs that started out in the US move to other countries, where they feel the regulatory environment offers them a better chance of success. For example, property insurtech Trov was founded in the US, but it chose to launch in Australia and the UK ahead of its home nation. That's because, in both Australia and the UK, a new insurer only needs one license to be able to operate nationally, compared with the US, where a firm must obtain authorization on a state-by-state basis.

FINTECH INITIATIVES BY US REGULATORS

In recognition of the impact fintech is making on the financial services industry, several major US regulatory agencies have launched fintech-specific initiatives designed to help them better understand the opportunities and risks presented by the industry. Each regulator has its own initiatives and each appears to have different drivers. Some regulators are taking into account the issues associated with the current regulatory framework and are looking to make it easier for fintechs to develop and test new models. Others seem more concerned with enabling legacy players to innovate.

NOTABLE US FINTECH INITIATIVES BY FEDERAL REGULATORY BODIES

Regulatory Body	Initiative	Date Active	Outcomes To January 2017
Consumer Financial Protection Bureau (CFPB)	Project Catalyst	2012 Findings report published 2016	1. Launch of regulatory initiatives designed to facilitate the testing of new fintech products and services 2. Ongoing communication in formalized setting with fintechs and other regulators 3. Report published October 2016 outlining the benefits of fintech for consumers
Office of the Comptroller of the Currency (OCC)	Supporting Responsible Innovation	March 2016	1. Whitepaper featuring 8 guiding principles for designing a regulatory framework specifically for fintech published March 2016 2. Request for comments issued due to close May 2016 3. Report published October 2016 outlining next steps and confirming the creation of an Office for Innovation 4. Plans announced to consider applications for national charters from fintechs
Securities and Exchange Commission (SEC)	1. Regulation updates that facilitate equity crowdfunding 2. Consideration of regulation to update intrastate funding rounds 3. Fintech forum	May 2016 Ongoing Nov 2016	1. Regulation A+ — businesses can raise up to $20 million or $50 million using crowdfunding, with the higher amount requiring more disclosure 2. Title III of the JOBS — startups and small businesses in the US can raise up to $1 million in 12 months with reduced reporting requirements
US Treasury Department	1. Recommendations on marketplace lending	May 2016	Recommendations regarding ongoing monitoring of the industry
The Fed	1. Online lending forum 2. Exploration of blockchain technology	Dec 2016 Ongoing	Multi disciplinary working group focused on better understanding fintech

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The Office of the Comptroller of the Currency. The federal banking regulator acknowledged it could no longer ignore the growth and importance of the fintech industry on banking in November 2015 when it launched the Responsible Innovation Framework initiative. The initiative aims to help the OCC create a regulatory framework that encourages innovation by institutions with a federal charter (almost exclusively incumbent banks as of January 2017). So far the results of that initiative have been:

- A report published in March 2016 sounding out eight guiding principles for developing that framework. The guiding principles fit into four areas: fostering financial innovation consistent with sound risk management; protecting consumers; promoting collaboration; and improving communication.

- The decision to create an **Office of Innovation** was made in October 2016. The Office is expected to be operational in Q1 2017 and will be responsible for gathering knowledge to provide a basis on which the OCC can build its framework. In order to achieve its objectives, it will: create an outreach program for banks and fintechs; work alongside other US and international regulators to share knowledge and develop consistent approaches; enact education and awareness initiatives for its own staff; conduct research; and potentially launch a sandbox for banks and their fintech partners.

- The OCC announced it would accept applications from fintechs to become **special-purpose national banks** in December 2016 and issued a white paper outlining some of the conditions successful applicants would have to meet. The OCC issued a call for feedback on its decision and white paper that was due to close in January 2017. Fintechs awarded a special-purpose charter would be able to operate nationally, without the need to go through a state-by-state licensing process.

The OCC's initiatives are the most hopeful for both incumbents and fintechs so far. The initiatives announced in October 2016 are designed to enable federally chartered institutions to more easily experiment with new products. And while most major banks have already invested heavily in innovation, this could be the stimulus smaller institutions need to kick off their own projects. Its decision to allow fintechs to apply for a federal charter bodes very well for lending and payments fintechs, though these firms would still have to get Federal Deposit Insurance, as well as abide by regulations from other agencies, including the CFPB.

A potential hurdle for the OCC to overcome before it can start issuing such charters is opposition to and negative feedback on its original proposal from unexpected sources — Senate Democrats and New York State's regulator. Both have raised objections to the initial proposal on a number of grounds, including lack of detail and potential for misuse by large retailers.

The Securities and Exchange Commission. Responsible for oversight of the securities industry, various areas of fintech fall under the SEC's remit, including robo-advisors and online lending. The agency has several ongoing projects related to fintech.

- **Exploration of fintech by an internal working group, including a fintech forum.** The SEC held a public forum for regulators, entrepreneurs, and financial industry experts to discuss how regulation applies to new technologies in November 2016. Its motivation is the potential benefits of robo-advisors, blockchain, online lending, and crowdfunding to the securities industry, as well as the need to identify potential risks to investors. As yet, it's still in exploratory mode. However, Mary Jo White, chair of the SEC at the time, said it was looking to issue internal guidelines on how to improve clarity on the regulatory situation, and wasn't averse to proposing new rules.

- **Ongoing changes to securities regulation to foster the growth of crowdfunding.** These updates to existing regulation under the JOBS Act include allowing nonaccredited investors to participate in crowdfunding rounds and creating new options for firms looking to raise money. The latter measure includes creating a special filing option for startups wanting to raise up to $1 million that comes with reduced reporting requirements. The aim of these measures is to increase availability of capital for small businesses.

The Consumer Financial Protection Bureau. The CFPB's remit extends to all consumer-facing financial services products, including bank accounts, loans, savings accounts, and credit cards. Its goal is to ensure consumers are adequately protected from the actions of their financial services providers, and it has a number of fintech initiatives in play.

- **Ongoing monitoring of online lending.** The CFPB started accepting complaints regarding online lenders in March 2016. It uses its complaint database to determine how it supervises companies, enforces laws, and writes regulations, which suggests CFPB could be getting closer to creating online lender-specific regulation.

- **Project Catalyst** is an initiative launched in 2012 to encourage innovation in financial services that benefits consumers. It released a report in October 2016, which found that many areas of fintech offer significant opportunities to improve financial products and services for consumers. Consequently, it plans to continue running and expand initiatives designed to encourage further innovation. These initiatives include:

- An Office Hours program that offers firms the chance to book consultations with CFPB experts across various areas.

- A policy to encourage Trial Disclosure Programs, which effectively acts like a sandbox.

- The introduction of No-Action Letters, which amount to a promise issued by the CFPB to a company experimenting with fintech that it will not take disciplinary action against the firm for a set length of time.

The CFPB's initiatives are very fintech-friendly. They encourage the growth of startups and should provide hope for fintechs in multiple segments of financial services. Key to the potential success of the CFPB's initiatives is its willingness to engage with startups — this is vital if regulators want to understand new business models and create appropriate rules accordingly. The snag is that the CFPB's initiatives are nonbinding, so while it may not prosecute nonregulated firms for experimenting, it can't promise that other agencies won't.

The US Treasury Department. The US Treasury issued a white paper in May 2016 outlining the opportunities and challenges in online marketplace lending. It included a set of recommendations the Treasury planned to initiate to encourage other agencies to work toward the establishment of industry standards and best practices. To that end, it recommended a working group be formed with a representative from each of the Treasury, CFPB, FDIC, FRB, Federal Trade Commission, OCC, Small Business Administration, and SEC, and a representative of a state bank supervisor. The desire to form a joined-up approach is commendable as it is more likely to result in one, coherent, set of rules for online marketplace lenders to follow. But the proposal neglects to include any members from marketplace lenders themselves, which could make it hard for the agencies to truly understand the firms' business models and hinder their ability to make appropriate rules.

The Federal Reserve Board. The Fed outlined its initial approach to fintech by way of a speech given by Governor Lael Brainard in December 2016, notably a fair while after other agencies. Brainard outlined a number of areas in which the Fed already has ongoing initiatives, but failed to elaborate on any potential policy updates or changes.

- **Partnerships between fintechs and banks.** Due to the increasing number of these partnerships, the Fed is revisiting its guidance for incumbents on how to ensure the potential risks of working with third parties are appropriately understood and managed. The outcome of the review could be clarifications or adjustments to existing guidelines to make such collaborations easier, according to Brainard.

- **Fintech engagement.** The Fed has been actively engaging with players across the fintech industry. It has a multidisciplinary working group that aims to better understand new technology, and has established channels of communication with fintechs in innovation centers across the US. One aim of such outreach is to better understand the hurdles preventing innovative firms from developing products and services that could have wide reaching social benefits — increasing financial inclusion, for example.

- **A forum on "Online Lending to Households and Small Businesses."** The Fed is interested in online lending because it's arguably one of the oldest and largest fintech segments. That means there has been time to gather data on the segment's performance, as well as associated risks and opportunities. Another reason for the Fed's interest is that US regulators are increasingly cracking down on payday lenders, which issue near-instant loans to consumers unable to access credit elsewhere at extortionate interest rates. Most regulators believe these lenders to be targeting vulnerable people and leading them further into unmanageable debt. But their removal would likely leave some demographics, notably the unbanked, without access to credit. There is an opportunity for online lending to fill this gap, but the Fed — and other regulators — will want to make sure of the security and robustness of such business models before allowing that to happen.

The Fed would like to mold the US' overall approach to fintech. As the country's central bank, the Fed likely feels it is a natural role for it to fill. That said, it took a lot longer than many other agencies to even outline an approach and has yet to make any specific policy recommendations — which means it is more likely that another regulator, conceivably the OCC, will end up shaping the future of fintech — at least at first.

STATED DRIVERS BEHIND REGULATORS' FINTECH INITIATIVES

Driver	OCC	CFPB	SEC	Treasury	Fed
Consumer protection	✓	✓	✓		
Increased consumer access to credit	✓	✓		✓	✓
Increased access to capital for businesses	✓		✓	✓	
Increased competition		✓			
Increased consumer access to financial products	✓	✓	✓	✓	

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Potential Positives From US Approach To Fintech

Despite problems with the existing regulatory environment, there may be some advantages to US regulators' approach to fintech in comparison with that of the EU or UK.

- **More time to learn and gather information.** This enables US regulatory bodies to observe swifter regulators and see what works and what doesn't, so when it comes to making any future changes, they may be able to implement them more smoothly, and with less risk.

- **Less risk to the legacy financial services industry.** Financial regulations in the UK and EU are largely driven by what would most benefit consumers, which most regulators in these regions agree is greater competition — and therefore more fintech. US regulators are more cautious, and not unanimous in their desire to make it as easy as possible for fintechs. It's possible that the motivations and policies of the EU and UK regulators could result in inadvertent damage to the legacy industry if they end up promoting fintechs at incumbents' expense.

- **Other regulators run the risk of announcing many initiatives and not being able to back them up due to lack of resources.** In particular, the FCA has shown signs of being overstretched, partly due to the overwhelming popularity of its sandboxes and fintech-specific licenses. In March, it was forced to issue a statement saying that delays to its licensing process for marketplace lenders were in part due to high numbers of applicants.

THE FUTURE OF US FINTECH REGULATION

The biggest regulatory hurdle to the further development of US fintech remains the number of regulatory bodies. This includes the fact that there are numerous federal regulators, as well as the existence of both federal and state-by-state oversight programs. Several major US agencies have recognized this and agreed on the need to work together to establish more regulatory clarity for fintechs. That could take one of several forms — the creation of a specific regulatory framework for each fintech segment, or the publication of clear guidelines on how fintechs fit into existing frameworks, for example. To decide which form is best, lawmakers will need to work together extensively, involve fintechs in their discussions in order to fully understand how new business models work, and learn from foreign regulators that have already implemented fintech-specific guidelines or frameworks.

Given the different approaches of various agencies, the potential difficulties with overhauling the entire system, and the fact most regulators emphasize their cautious approach to the industry and the need for further investigation, it is unlikely that we will see any specific regulatory framework in the next year or so. Instead, guidelines are likely to emerge designed to provide clarity on how existing regulation applies to fintechs. That will likely be followed by the emergence of an industry of experts who specialize in advising fintechs on how to work within those guidelines — including both lawyers to interpret the law, and compliance experts to advise firms on remaining within it. This could be an opportunity for regtechs, which aim to make it easier and cheaper for financial firms to achieve compliance. And because many regtechs are designed to scale as required, they can offer other fintechs services at lower prices than legacy compliance options.

Longer term, any sector-wide regulatory framework will likely focus on innovative firms that do not fit into existing regulation — this could resemble the UK's Project Innovate and various countries' sandboxes, for example. The creation of such a framework would require close cooperation between agencies, and potentially a cross-agency supervisory group. More specific regulation for individual segments, such as marketplace lending, will likely follow once regulators have decided which agency is responsible for each business model.

The Impact Of A Trump Presidency On Fintech Regulation

It's likely that some of President Trump's policies will impact the US fintech industry, but the full implications aren't yet clear. It will take time for the new president to establish himself and clarify policies, and most agencies are likely to remain in information-gathering mode, as his positions grow apparent. It's also important to remember that fintech is a long way down on the list of priorities, as in the near term, the Administration will be concerned with ensuring the transition goes smoothly and enacting policies for the broader financial sector.

Meanwhile, agency heads are unlikely to change immediately. The notable exceptions will be the Treasury, which will find itself with a new Secretary appointed by Trump relatively quickly, and the SEC as Chair White stepped down in January 2017. President Trump's nomination for her successor is Jay Clayton, and aside from his involvement in Alibaba's US IPO, his fintech credentials remain unknown.

Longer term, legacy players could become better placed to compete with fintechs. That's because a reduced regulatory burden, as advocated for by Trump, would likely result in reduced expenditure on compliance for incumbents, freeing up money for other projects — like innovation initiatives. It could also mean more freedom for banks to experiment with new products and services without the constraints of regulation and threat of retribution. This might make it harder for fintechs to compete, furthering the trend in partnerships and acquisitions we've seen recently.

THE BOTTOM LINE

- Global financial regulation ballooned after the 2008 financial crash. In fact, the number of regulatory publications, changes, and announcements increased 492% between 2008 and 2015.
- Heavy regulation can hinder innovation, and this issue is exacerbated in the US by the existing regulatory framework.
- Fintechs are using different models to achieve compliance — but none are ideal.
- Meanwhile, the US is notably behind when it comes to establishing a coherent policy on fintech.
- Some US regulators realize the benefits fintechs offer and have implemented initiatives to make compliance easier.
- But a supportive regulatory environment for US fintechs is still a long way off, as these initiatives vary widely and have little overlap with each other.
- The full implications of a Trump administration aren't yet clear for fintech. In the meantime, most agencies are likely to remain in information-gathering mode.

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