Consumer Finance Monitor (Season 7, Episode 19): A Close Look at the Consumer Financial Protection Bureau's Proposal to Supervise Large Nonbank Providers of Digital Wallets and Payment Apps

Speakers: Alan Kaplinsky and Brian Johnson

Alan Kaplinsky:

Welcome to our award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services, what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. And I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr. And I am pleased to be moderating today's program for those of you who want even more information about the topic we'll be covering today or for that matter, everything going on in the consumer financial services world. Don't forget to consult our blog, also going by the name, Consumer Finance Monitor.

We've hosted the blog since July 21, 2011 when the CFPB became operational. So there is a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the list for our webinars, please visit us at ballardspahr.com. And if you like our podcast, please let us know about it. You can leave us a review on Apple Podcasts, YouTube, Spotify or whatever platform you use to access your podcasts. And also, please let us know if you have any ideas for another topic or topics that we should cover during our show or speakers that we should consider inviting as guests on our show. So today, I am joined by a very special guest, Brian Johnson.

Let me tell you a little bit about Brian. He is the managing director in the banking Supervision and Regulation Group at Patomak Global Partners, a leading financial regulatory advisory firm. In his role, he spearheads strategic and compliance projects, related to the regulation of consumer financial products and services. Prior to joining Patomak, Brian was the partner in Alston & Bird's Financial Services and Products Group. He also served in government as the deputy director of the CFPB, where he advised two directors, provided strategic direction to the Bureau's rulemaking supervision and enforcement efforts and coordinated interagency activities, including on the Deputies committee of the Financial Stability Oversight Council, or more commonly called FSOC.

Prior to his time at the CFPB, Brian served as the chief financial institutions counsel and policy director for the House Committee on Financial Services. So Brian, a very warm welcome to you.

Brian Johnson:

Thanks Alan. I've been an avid reader of the Consumer Finance Monitor blog going back to May, 2012 when I started working for the financial services committee. So consider me a huge fan and it's an honor to be here.

Alan Kaplinsky:

Well, thank you. Let me tell our audience what ... and you could talk about any number of topics and God only knows there's enough going on at the CFPB that we probably could talk the entire day, but I got particularly interested, Brian, in testimony that you gave before the Subcommittee on digital assets, financial technology and inclusion of the US House Committee on Financial Services, an entity for which you used to work at one time. So you're very familiar with how they function. The hearing was entitled Bureaucratic Overreach or Consumer Protection? Examining the CFPB's Latest Action to Restrict Competition in the Payments Field.

So we're going to be focused on the written and oral testimony that you provided to the House Financial Services Committee, particularly with respect to a proposed larger participant rule. So I have a lot of questions I'd like to pose to you today, but let's start off with some of the easier issues. So as I mentioned, you testified before the committee on that hearing that they conducted regarding the CFPB and what it was doing in the payments area. So let's try to unpack what is happening, Brian. First, what authority is the CFPB trying to exercise here?

Brian Johnson:

Well, thanks Alan. The hearing is interesting. I think it's the first time that a congressional subcommittee has devoted an entire hearing to one of these larger participant rules. So wind back the clock to the Dodd-Frank Act passed in 2010, which created the CFPB. Congress grappled for the first time with how to go about supervision of non-depository institutions, non-banks. And prior to Dodd-Frank, the FTC for instance had jurisdiction over non-banks but not supervisory authority. So in creating the CFPB, Congress enacted statutory provision called Section 1024 of the Dodd-Frank Act, and it created supervisory authority for the CFPB over non-depository institutions.

Interestingly, there are features of that non-bank supervisory authority. So Congress designated certain providers like payday lenders, mortgage originators, mortgage servicers, private student loan providers, by statute as covered persons subject to CFPB supervision and examinations. Then, it included effectively a catch-all provision that said the CFPB by rule can define other markets and quote, larger participants of those other markets for additional supervision by the CFPB. So it created the means by which the CFPB by rule can expand the scope and reach of its own supervisory authority.

Alan Kaplinsky:

Right, as you indicated or alluded to it, what you just said, this isn't the first time the CFPB has used this authority, right? They've done it on several other occasions. And maybe you could tell us just a little bit about that.

Brian Johnson:

Sure. So this is the first time in recent history I would say, although the CFPB itself is still young, opening the doors in 2011, but under Director Cordray's prior tenure as the head of the CFPB, he promulgated five other larger participant rules on defining markets and larger participants in those markets on some of the standard areas of consumer finance that you might assume would've been covered by Congress but weren't. So consumer reporting market, the consumer debt collection market, student loan servicing, international money transfers and automobile financing. So the CFPB's more recent proposal would be the sixth in a series of CFPB rules, defining ever broader scope of its supervisory authority.

Alan Kaplinsky:

It looked for a while that the next larger participant rule would not be in the payments area. I thought it was going to be in the area of installment lending, so that it would capture what the non-bank consumer finance industry is engaged in. One would think a more important area to cover than payments, sort of surprised it wasn't covered by Congress itself.

Brian Johnson:

I'd argue it would be an easier market to define than the market definition that the Bureau has tried to cobble together under the proposed rule.

Alan Kaplinsky:

Yeah, so in a larger participant rulemaking, Brian, what does the CFPB need to accomplish?

Brian Johnson:

So as a matter of statute, it has to consult with the FTC, the precise meets and bounds of what's necessary for consultation is not known. And there was some curious language in the CFPB's proposal where it said that it consulted with the FTC or provided an opportunity to consult. So it's actually unclear whether consultation occurred or whether it will occur and what constitutes consultation. Is it a phone call over to somebody at FTC? Is it a sit down? Nobody really knows there. So not a high bar to clear from a statutory perspective for the Bureau. The two core tasks in a larger participant rulemaking is it has to define a clear market and then, it has to establish some sort of means of identifying the larger participants of that market.

And the Bureau has incredibly broad authority. One thing I raised in my testimony is a potential non-delegation problem here because reviewing courts typically look to an intelligible principle standards that an agency follows in trying to effectively write this rule. And there's no factors that Congress established in Dodd-Frank that would require the CFPB to run through a particular type of analysis to define a market or to set transaction or size thresholds, to determine which institutions are and are not larger participants. So it has ... effectively, the CFPB has carte blanche to define markets as it wishes and then, to establish some sort of mechanism for distinguishing larger from smaller participants.

Alan Kaplinsky:

Right, so the rule ... one of the sort of fundamental things about a larger participant rule, it's got to define a market. So what did the CFPB do here. How did they go about defining a market? It struck me as sort of a mishmash. It wasn't that very clearly defined, at least to me.

Brian Johnson:

It's not. I mean, it's difficult actually to read through the seven pages of text in the Federal Register Notice and reach any logical conclusion about what exact type of activity the CFPB is hoping to cover here. It provides nested definitions. So the market is for a general use digital consumer payment application, but each of those terms, in turn, have their own definition. So it means provided either a covered payment functionality through a digital application for consumer's general use or making consumer payment transactions. And then the Bureau goes on to define consumer payment transactions, covered payment functionality, defines a term digital application and general use.

The conclusion I drew and provided in my testimony is that it appears that the Bureau backed its way into a definition. In other words, it decided what it wanted to be covered and then, created definitions that would cover what it wanted rather than articulate and describe an existing coherent market for a consumer financial product or service. And one kind of rough heuristic you can point to, to understand how this is happening is I went back to the Federal Register notices for each of the five prior larger participant rules and just counted the number of pages the Bureau used to describe the markets in those prior larger participant rules.

And on average, it was two to three pages used to describe coherent markets. For instance, auto finance markets, where there are existing well-understood products that may be substitutes for one another, et cetera. A stark contrast can be drawn between those prior market definitions and discussions in the older rules and the Federal Register notice for this larger participant rulemaking, which sprawls over seven pages, just to try and reach a definition of the market and the products that would fall under that market to be covered. So it's a bit of a head-scratcher.

My only conclusion again is I think they tried to back in based off of what they really wanted covered rather than describe a coherent market with close substitutes of products being offered.

Alan Kaplinsky:

Yeah. All right. So they go through seven pages and how do they propose to define the market?

Brian Johnson:

Well, I went through some of the definitions and there are a number of comments filed by market participants that said, look, there's ambiguity here. It's not entirely clear to us what functionalities would be covered, why certain functionalities which are unlike. For instance, fund transfer functionality and wallet functionality, very different processes and functions and products, why they would be lumped together here. And there was also concern raised and, essentially dicta in the rule, where the Bureau asserted for the first time in a novel definition of the term funds, that it had jurisdiction over digital assets including crypto assets, which in my view is the first time the Bureau has ever articulated this definition of funds to extend beyond fiat currency or legal tender to include digital assets.

And of course that steps all over SEC and CFTC jurisdiction and intrudes upon ongoing delicate conversations in Congress about how to establish a regulatory regime for digital assets. So at best, this is, I think the CFBB trying to leave its marker in the dicta of a rulemaking saying, "Don't forget us. We have a role to play here too," but to bury within definitions and assertion of broad authority that's subject to current legislation, in the context of a larger participant, rulemaking again strikes me as improper. And if the Bureau wants to define funds for purposes of Title 10 of the Dodd-Frank Act, I think it should do it upright in either an interpretive rule or a standalone rulemaking to assert formal jurisdiction over digital assets.

So there's a lot of ambiguity in the nested definitions for the market definition and some novel approaches that the Bureau is using to try and extend its jurisdictional reach even further.

Alan Kaplinsky:

I guess if I could put a name on what they're doing here, I guess I would call it stealth regulatory creep, that sort of a backhanded way of regulating digital assets, which prior to this occurring, they haven't done very much, at least I can recall. How many companies, is there any way to figure out how many companies would be covered under this new proposed rule, assuming it were finalized as proposed?

Brian Johnson:

It's a difficult proposition. So it provided its market definition and then, provided the transactional threshold for identifying the larger participants in that market. And the definition supplied was a non-bank that provides an annual covered consumer payment transaction with a volume of at least five million transactions. And also, that the non-bank is not defined as a small business concern under the small business Administration's size standards. So in the proposed rule, the Bureau estimated that 17 institutions would become subject to examination if the rule was finalized substantially as proposed, but then, in a footnote in the proposal, the Bureau noted that it's identified about 190 institutions that could be subject to the rule, but it didn't have data sufficient to determine whether or not all of those institutions actually were subject to the rule.

So it could be far more than the 17. The Bureau stated that it had data sufficient to determine that 17 would become subject to the rule, but nobody really knows based off of the definitions, given the ambiguity, how many institutions actually will become subject to supervision under the final rule.

Alan Kaplinsky:

Okay. So we've covered the proposed definitions. Let's talk about the CFPB's rationale for the rulemaking. Why do they want to extend their supervisory authority over these 17 or possibly 200 non-bank companies?

Brian Johnson:

Well, it's an interesting question you raise Alan because there's a longer history here than just the proposed rule. So you get a different answer I think, if you're just reading the rationale articulated in the proposal versus the broader context of all of the Bureau's activities in this area over the past couple of years. So starting just with the text, it's natural to say, why do they want to do this, to go to the text of the proposed rule and say, "Okay, well what are they saying about the reasons that justify the rulemaking?" Interestingly, there's a one sentence description of the purpose of the rule in the proposal, and the Bureau simply says that it's proposing to establish its expanded supervisory authority quote, because this market has large and increasing significance to the everyday financial lives of consumers. So that's not a lot to go on.

I mean, there's different ways to interpret that. One way is increasing markets here in the digital asset and digital payment space is a bad thing, but the Bureau doesn't actually articulate any emerging risk to consumers from participating in any of the product holding assets, transferring assets, having digital wallets or participating in any aspect of the markets identified. That leaves you with less than I think would normally be satisfying and trying to understand the reasoning that an agency is employing for engaging in a formal rulemaking process. Similarly, the Bureau doesn't identify any market failure here. So it's not pointing to some inefficiency in the marketplace that should give rise to regulatory intervention.

So I have to look outside of the four corners of the proposal to better understand maybe some of the motivations of the director, based off of the recent actions by the CFPB. And there, you go back to 2021 when the CFPB issued its so-called

1022 orders, which is part of ... not its supervisory authority, not part of its enforcement authority, but rather a market monitoring authority which permits the Bureau to issue orders to gather information for the purpose of understanding broad market trends and reporting to the public about those trends.

And breaking from all historic precedent, the Bureau issued these orders and then, publicly noted that it was issuing these orders and then publicly stated which companies it was issuing the orders to. So at that time, it issued what the Bureau termed to be, its big tech orders, and noted that it had sent the orders to six companies, Apple, Amazon, Facebook, Google, PayPal, and Square. And if you go back and read the substance of the orders issued at the time, it goes well beyond identifying risks to consumers or emerging trends in the offering or provision of consumer financial products and services.

It actually sought to understand what the companies were doing in the payment space in terms of developing internally future products, which goes beyond the purpose I think, of market monitoring because you're not monitoring current markets, you're trying to understand what the companies are up to, what they may be developing in terms of future offerings, which may or may not ever enter into the marketplace. So interesting orders, but Director Chopra at the time, made a series of public statements where he expressed concern about the so-called big tech companies, said that he believed that their businesses can gain tremendous scale and market power, can learn and monetize data about consumer behavior.

He speculated about whether or not big tech companies will exploit their payment platforms to interfere with fair, transparent and competitive markets. Now, it's beyond the scope of our discussion here today to understand whether or not these concerns are valid. I only note that these are fundamentally concerns about market power and antitrust concerns, which are really the providence and jurisdiction of the FTC and DOJ. So these were not expressions of concern about risks to consumers in the operation of consumer financial markets, but rather market abuses or market power issues and antitrust concerns with respect to the operation of tech firms.

So it's interesting that it appears to be that antitrust concerns are driving the director's concern here. He was of course before director of the CFPB, a commissioner at the FTC. And so maybe some of those concerns developed at the FTC have carried over here, but that seems to be the thrust of the director's concern with respect to the entry or potential entry of some of these large tech firms into the consumer payment space. So I'm just left to conclude, given the dearth of explanatory analysis in the CFPB's rule, that those are the types of concerns that are driving the interest of the CFPB in gaining exam authority over these firms so that it can go in a more comprehensive fashion, under examination authority to open the book, so to speak, and really figure out what those types of companies are up to.

Alan Kaplinsky:

Yeah, of course. This isn't Brian, the first time that director Chopra and his statements and other issuances by him that he's been focused on antitrust issues. In fact, we've often in our blog called him to task for encroaching on the FTC and DOJ, and I'm wondering, you don't think he's like a stalking horse for FTC and DOJ that he's trying to get all this information and when he identifies things that he thinks are antitrust violations, he'll send that information over to FTC and DOJ. He's not doing that, is he?

Brian Johnson:

Well, I mean, it's an interesting question because increasingly the Bureau is coordinating with the activities of other agencies, including the FTC. This issue came out also in the hearing at which I testified where members who are generally supportive of the Bureau expressed concerns about, big tech firms mentioned that they were concerned about market concentration, misuse of market power, of market dominance. And if I could point to one thing that maybe wasn't discussed fully in the hearing, it was that the CFPB, though it has broad authorities, there are limits to that authority. And its statutory role is to enforce and administer federal consumer financial law, which is a defined term of art, which includes 18 enumerated statutes and Titles 10 and 14 of the Dodd-Frank Act, and it has a handful of other authorities.

Nowhere in any of those definitions is antitrust law included within the CFPB's jurisdiction. So to the extent there's an interest, I argued that that interest is largely irrelevant to a larger participant rule and supervision of these types of firms because the CFPB's supervisory authority that which it can go examine institutions for is limited to violations of federal consumer financial law, not antitrust concerns.

Alan Kaplinsky:

Right, right, right. So let's turn to another criticism that you had of this proposed rulemaking. And that pertains to the requirement that they conduct a cost-benefit analysis. That's something required by the Dodd-Frank Act itself. You supervise the development of these cost-benefit analyses during your time at the Bureau. What do you make of the Bureau's effort regarding a cost-benefit analysis? Pretty weak, huh?

Brian Johnson:

You're right. I did help with the process and oversee the development of these types of analyses. The Bureau has within the expertise and capabilities of the economists that work within the RMR division to put out, I think robust economic analysis of the cost and benefits associated with a change in regulation. I don't see that robust analysis in this rulemaking, and the Bureau essentially throws up its hands and just states in the rule that it quote, notes at the outset that limited data are available with which to quantify the potential benefits, costs, and impacts of the proposed rule.

So in light of these limitations, it says that it just generally provides a qualitative discussion of the costs and benefits, rather than the quantitative analysis. And maybe the one area that I think is most illustrative of the lack of meaningful analysis in this cost-benefit portion of the proposed rule is the one area where it actually tried to quantify costs and it quantified the cost of a CFPB examination to an institution and arrived at the conclusion that in the course of an eight-week plus CFPB exam, modern CFPB examination, an institution would be estimated to involve one compliant staffer and part-time of one attorney in-house to assist the CFPB with the conduct and completion of its entire exam.

It estimated that the all-in sunk costs of an examination is $25,000. Now, I'd be curious, Alan to know, based off of your experience and those attorneys at Ballard, if you think that estimate of the cost of the CFPB exam is anywhere near reality?

Alan Kaplinsky:

Yeah, it's not and I mean, I could roll back the clock to 2011 when we were helping non-banks prepare for those that were named in Dodd-Frank subject to supervision. And it's a very large undertaking, particularly for companies that haven't previously been examined at the title level ...

Brian Johnson:

And here's where my criticism lies. So the formula, the methodology that the Bureau used to arrive at that number was a methodology at first used in 2012 as part of one of the first larger participant rules. And if you wind back the clock that was one year into CFPB's existence, they're still winding up the exam process. You could maybe give them a pass and say that there's a lack of a track record there with which to estimate the cost to institutions of the then, very new examination process, but wind the clock forward, a dozen years and thousands of exams later, I think there's no justification for continuing to maintain that original methodology in light of the fact that the CFPB has the experience of interacting with hundreds of institutions.

Thousands of institutions over that twelve-year time span to really understand what the resource requirements are for those institutions. So when the Bureau claims that there's a lack of quantitative data and that it's going to rely on qualitative analysis, I just think it hasn't done its homework because there's readily available information within the CFPB's records to come up with a better methodology for estimating the cost of CFPB exams for these larger participants in this new market.

Alan Kaplinsky:

Yeah, so what other aspects of the proposal stand out to you? Things that we haven't already covered?

Brian Johnson:

Well, I mentioned this once. I think there are some shortcomings in general with the CFPB's more recent approach rulemaking. And the one that stands out to me most is the lack of identification of a market failure to justify a rule. That's long-standing, standard, rulemaking practice for all agencies. And the real comparator here that I would point to is Director

Cordray's rule-makings. Sometimes very large rule-makings, sometimes very controversial. So leaving aside whether or not you agreed or disagreed with the policy or the rule-makings themselves, one aspect of Director Cordray's rules was there was almost invariably an identification of market failure even for directed rules, not just for discretionary rules.

And then, a fairly detailed analysis of the nature of that market failure and then, a rationale that says, we are going to intervene in this market to address that precise market failure, and we're trying to tailor the regulation in ways that would address that market failure without having undue unanticipated consequences. So you don't see a discussion of market failure in this larger participant rule. You frankly don't see it in any of the more recent rules coming out of the agency, including all of the so-called junk fees rules with credit card late fees, and with overdraft and with the NSF rule. So that is a stark departure from agency practice.

And fundamentally, if the agency is not trying to rationally articulate a rule based off of an identification of a problem, it's really an agency whose authority is becoming unbound from current market conditions where it can just rove around and explore and issue rules as it wishes. And I think ultimately that's a counterproductive approach to regulation. I think it opens the agency up to potential challenge and has significant, I think, implications for the rule of law and the predictability of the agency rulemaking process. So that I think is a notable additional aspect of this rule that kind of rings through loud and clear, both with this rule and in the other major current agency actions.

Alan Kaplinsky:

Yeah. So let's talk a little bit about hearing itself, where you testified. What did you make of the hearing?

Brian Johnson:

Well, I thought it was ... I've noted some aspects of it. It's always interesting to be on the other side of the witness table. I spent almost six years writing questions for witnesses, for members to consider. So very different experience, of course now, responding to questions in real time, going into the hearing, I thought it was interesting that there was bipartisan concern expressed by the members of the subcommittee, and there were a series of letters that were written to Director Chopra, asking for the agency to slow down the process. The comment period, I think across the board was viewed as insufficient amount of time for industry and other interested members of the public to weigh in on aspects of the rule.

The bureau departed from standard practice of 60 days comment period here, and really jammed comment writers by opening up the public comment period over a series of three holidays and running it concurrent with the 1033 rulemaking comment period. So members had expressed on a bipartisan fashion, I think frustration with the bureau prior to the hearing. Hearings are always in part political theater. So, the bipartisan concern didn't necessarily bear out in member statements. And overall, I thought the members who wanted to support the bureau and its effort express these general concerns about big tech companies and the concerns about the abuse of market power.

I didn't have the opportunity to help remind the members, who had established the CFPB through statute that it's not ... the bureau is not a securities regulator, it's not a commodities regulator, it's not a prudential banking regulator. It has no safety and soundness mission. And it's not an anti-monopoly, anti-trust regulator. The FTC and the banking regulators and SEC and CFTC all have those jurisdictions. CFPB has a unique mission, which is to enforce and administer federal consumer financial law. So I thought some of the effort was to beat up on big tech a little bit, and that makes for statements that appear on YouTube, et cetera.

Some of the discussion I thought missed the mark, which was the limit of the reach of CFPB's jurisdiction and whether or not this rule was actually tailored to address a legitimate concern for consumers in the consumer finance marketplace. So I credit the chairman for taking valuable committee time to highlight some of the aspects of this rule, and I think it did a good job, the hearing in noting some of the limitations or problems with the proposal. In an ideal world, I think the Bureau would go back to the drawing board, rework its market definition in a way that's workable and articulate particular reasons why there are risks to consumers in that redefined market and move forward.

As you know, there's a timing component here. We're in an election year. So, I think it's probably ultimately unlikely that the Bureau would do that.