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BANKING-AS-A-SERVICE: FINTECHS WALKING THE REGULATORY PERIMETER

ABSTRACT

Financial technology (fintech) has ushered into today's financial markets a wave of innovations that have revolutionized the way financial services are rendered and consumed. One such transformation is Banking-as-a-Service (BaaS): a partnership model through which nonbank businesses offer federally regulated banking products directly to consumers. By disintermediating the banking value chain, BaaS is democratizing access to financial services and lowering barriers to entry for many unbanked and underbanked individuals. Despite these benefits, BaaS initiatives bring with them a number of concerns—such as data privacy risks, new forms of surveillance and discrimination, and economic instability—that are augmented by a systemic deficiency in regulators' ability to understand and respond to complex and evolving fintech-related risks. Specifically, the United States' overlapping state-federal regime of financial regulators has created a fragmented network of authority, exposing new and enticing opportunities for service providers to organize their activities outside the purview of regulators. Furthermore, the modern regulatory infrastructure was designed in the wake of the 2008 financial crisis and focuses almost exclusively on the propagation of risk within and among banks and large financial institutions. This Note argues that this system is ill-equipped to address BaaS-generated risks and proposes that a solution may be found in a redefined regulatory perimeter.

INTRODUCTION

Technology has fundamentally altered the world in which we live; it evolves on its own terms and without regard to those it affects—and its impacts reverberate through nearly every aspect of our lives. Similarly, technology and innovation have consistently been catalysts for change across all industries, signaling their force through "the emergence of new business models, the disruption of incumbents, and the reshaping of production, consumption, transportation, and delivery systems."[1] Within this ever-changing global economy, the financial services industry stands out and has grown particularly susceptible to the tides of technological innovation.[2] These vulnerabilities have bifurcated traditional banks in the United States: on one side, slow-movers are left with uncompetitive portfolios, inadequate and poorly integrated products and services, and static IT structures; while on the other side are banks working diligently to meet the transforming needs

1. KLAUS SCHWAB, THE FOURTH INDUSTRIAL REVOLUTION 7 (2016).

2. *See* Howell E. Jackson, *The Nature of the FinTech Firm*, 61 WASH. U. J. L. & POL'Y 9, 23 (2020).

of their customers.[3] This latter group is combating disruption through partnerships with financial technology firms (FinTechs)[4]—a relationship that is neither new nor unique to the United States but one that has continued keeping regulators a few steps behind. A recent example of one uniquely complex challenge can be found in the emerging "Banking-as-a-Service" model (BaaS), which has grown into the most popular form of contemporary partnerships for banks and financial technology firms.[5]

BaaS owes its beginnings to the expansion of the "Everything-as-a-Service" model—a method of cloud computing that enables service providers to digitize their product offerings and tap into troves of consumer markets previously unreachable.[6] These arrangements span from software to infrastructure to business process management—and even ransomware—and alleviate the financial burdens often accompanying shifting consumer needs.[7] In the past, businesses seeking to update or maintain legacy IT infrastructures had to make significant capital expenditures every few years.[8] Now, nearly every IT functionality can be outsourced and purchased as a service, with a provider relationship akin to a subscription model.[9] For the purchaser, this is not only a more economical outcome but also transforms capital expenditure line items into flexible operating costs.[10] Existing as an analog to this business model, BaaS is housed solely in the financial services industry and allows a chartered banking institution to make its technology and infrastructure capabilities available to nonbanks, typically FinTechs, on a "white-label" basis.[11]

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3. de Backer et al., *Banking as a Service: At the Heart of the Bank of Tomorrow*, ARTHUR D. LITTLE 2 (Feb. 8, 2022), https://www.adlittle.asia/sites/default/files/viewpoints/ADL_Banking_as_a_service.pdf.

4. "FinTech" and "fintech" are distinguished by use of capital letters. FinTech describes a category of service providers, while fintech is a term most aptly described as technology "that seeks to improve and automate the delivery and use of financial services." Julia Kagan, *Financial Technology (Fintech): Its Uses and Impact on Our Lives*, INVESTOPEDIA (June 30, 2022), https://www.investopedia.com/terms/f/fintech.asp.

5. In March 2022, Finastra, a financial software company and large proponent of both embedded finance and open banking, published a white paper study in which it found that "85% of senior [banking] executives surveyed are already implementing BaaS solutions, or planning to within the next 12-18 months." Dee Burke, Margaret Franco & Angus Ross, *Banking as a Service Outlook 2022 | Paving the Way for Embedded Finance*, FINASTRA 7 (Mar. 28, 2022), https://www.finastra.com/sites/default/files/file/2022-03/resource-finastra-baas-outlook-2022.pdf.

6. *The Rise of Everything-as-a-Service (XaaS)*, PURE STORAGE, INC., https://www.purestorage.com/knowledge/what-is-everything-as-a-service.html (last visited Mar. 10, 2023).

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *See* Regis Coeurderoy & Matilde Guilhon, *"Dancing in the Dark": Regulatory Reforms and Incumbent Banks' Evolution Towards New Value Creation Models in the Process of Open Banking* 2 (École Supérieure de Commerce de Paris, Impact Paper No. 2022-24-EN, 2022), https://academ.escpeurope.eu/pub/IP%20N°2022-24-EN_V2.pdf.

During their short tenure, BaaS partnerships have been shown to increase access to financial products for many unbanked and underbanked consumers. For example, Stilt, a United States-based FinTech firm, aims to democratize access to credit for immigrants and other underserved populations by resolving the "credit invisibility"[12] problems intrinsic to the American need-credit-to-get-credit scheme.[13] In this system, a lending institution's evaluation is limited mainly to an applicant's credit score, which in turn erects new barriers to entry for the tens of millions of Americans with little or no history with credit products or the United States financial system.[14] To remedy this systemic failure afflicting more than 10% of adults in the United States,[15] Stilt does not require customers to provide a Social Security number.[16] Instead, it makes lending decisions based on several holistic factors, such as employability, education, spending patterns, and the accuracy of information provided during the application process.[17] Stilt's continued success has allowed the firm to pivot from solely providing consumers with lending services to an expanded catalog of financial products powered by multiple BaaS partnerships.[18] One such connection has been made with Evolve Bank and Trust, through which Stilt facilitates FDIC-insured checking accounts.[19] As an added bonus to these deposit-holding

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12. *See* CONSUMER FIN. PROT. BUREAU, DATA POINT: CREDIT INVISIBLES 4 (2015) (using the term "credit invisibles" to describe the more than twenty-six million Americans that have no credit history with any of the three nationwide credit reporting agencies). Furthermore, the report notes a relationship between income and having a scored credit record, finding that persons of color and consumers in low-income neighborhoods "are more likely to be credit invisible or to have unscored credit records. These differences are observed for all age groups, which suggests that these differences emerge at young ages and persist over the lifetimes of these consumers." *Id.* at 22.

13. *See* Anna Baluch, *Stilt Loan Review: Personal Loans Targeted at Immigrants and the 'Underserved'*, CREDIT KARMA (Oct. 19, 2022), https://www.creditkarma.com/personal-loans/i/stilt-loan-review-for-immigrants.

14. *See* CONSUMER FIN. PROT. BUREAU, *supra* note 12, at 4. It is also important to note that many of the traditional metrics used by credit scoring agencies—such as payment history, amounts owed, and length of credit history—can be linked to generational wealth, to which many immigrants and persons of color have not had equal access. Failing to account for these systemic inequities perpetuates historical biases and further disenfranchises affected populations. *See* Natalie Campisi, *From Inherent Racial Bias to Incorrect Data—The Problems With Current Credit Scoring Models*, FORBES (Feb. 26, 2021, 9:00 AM), https://www.forbes.com/advisor/credit-cards/from-inherent-racial-bias-to-incorrect-data-the-problems-with-current-credit-scoring-models/.

15. CONSUMER FIN. PROT. BUREAU, *supra* note 12, at 12.

16. *How Does Stilt Decide Loan Approvals and Interest Rates?*, STILT INC. (Aug. 1, 2016), https://medium.com/stilt/learn-more-about-how-stilt-decides-loan-approvals-and-interest-rates-baf15ae2d2be.

17. *Id.*

18. Catherine Shu, *Stilt, a Financial Services Provider for Immigrants, Raises $100 Million Debt Facility from Silicon Valley Bank*, TECHCRUNCH (Jan. 27, 2021), https://techcrunch.com/2021/01/27/stilt-a-financial-services-provider-for-immigrants-raises-100-million-debt-facility-from-silicon-valley-bank/.

19. *Id.* These connections have also allowed Stilt to provide consumer loans at more sustainable interest rates. For example, Stilt averages rates between 12–14%, whereas other programs aimed at borrowers without Social Security numbers impose rates of 30–100%. *See id.*

accounts, Stilt can use an individual's transaction history to offer pre-approved loans.[20]

However, the United States' regulatory labyrinth does not wield much control over the provision of regulated financial products by unregulated firms, which has unsurprisingly augmented a number of risks.[21] More specifically, "[u]nregulated FinTech firms can tap into the regulatory perimeter to gain access to essential regulated services, and regulated firms can push out to FinTech entrepreneurs activities that may generate regulatory concerns or compliance costs."[22] This form of regulatory arbitrage poses a myriad of dangers to data property, consumer protection, and the integrity of the United States' financial services industry.[23] Furthermore, nonbank partners simply do not have the expertise needed to conform to the sound banking practices that federally regulated institutions have.[24]

The gap in regulatory authority looming over BaaS partnerships has captured the attention of regulators in the United States. The Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Consumer Financial Protection Bureau (CFPB), and the Federal Reserve have all jointly or individually offered their takes on the consumer protection and compliance risks posed by de-integrated digital banking platforms.[25] This Note will address these efforts and evaluate proposed and potential alternatives for restoring equilibrium to a market disrupted by BaaS's entrance.

The following section provides a brief background on the history and proliferation of fintech in the United States' financial services industry, as well as a foundational explanation of BaaS and its inner workings. Part II of this Note discusses current trends by domestic regulators to curtail threats

20. *Id.*

21. *See* Howell, *supra* note 2, at 15.

22. *Id.* at 23.

23. Comptroller Hsu's speech at the 2021 Fintech Policy Summit focused primarily on the risks unrestrained FinTechs pose to the safety of financial services. When discussing regulatory arbitrage concerns, Hsu stated:

> While FinTechs generally are subject to most of the same consumer protection regulations if they offer covered products or services, we have seen some FinTechs make technical, and questionable, arguments that their products or services fall outside the existing regulatory framework. In addition, FinTechs are not subject to the same type of regular, direct supervision as banks, and the enforcement authority for applicable consumer protection requirements on fintech activities is scattered among various federal and state regulators.

Michael J. Hsu, Comptroller, Off. of the Comptroller of the Currency, Remarks at the 2021 Fintech Policy Summit (Nov. 3, 2021).

24. *See id.*

25. *See, e.g.*, BD. OF GOVERNORS OF THE FED. RSRV. SYS., COMMUNITY BANK ACCESS TO INNOVATION THROUGH PARTNERSHIPS (2021). This publication, issued jointly by the FDIC, OCC, and Federal Reserve, addresses six common areas on which community banks may concentrate their efforts when considering the risks and benefits of a prospective business relationship with a FinTech company.

posed to consumers and financial markets by the unregulated provision of banking products. Part III will critique these efforts and examine the experiences of foreign regimes contemplating similar issues. Finally, this Note will conclude that the current labyrinth of authority in the United States is inapposite to managing the risks imposed by BaaS partnerships and suggests that a solution can be found in a redefined regulatory perimeter.

I. FINTECH'S INFLUENCE: EVOLUTION OF THE UNITED STATES' FINANCIAL SERVICES INDUSTRY

Fintech has been the enduring driver of evolution within the financial services industry.[26] As it is viewed today, fintech's notoriety can be traced back to the aftermath of the 2008 financial crisis when public perception of banks diminished considerably.[27] The post-crisis era brought new regulatory reforms, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act, which created an enhanced prudential regime for financial institutions deemed "too big to fail."[28] However, an unintended effect of these new protections was a contraction in banks' ability to compete within the financial services industry.[29] At the same time, many retail consumers, still distrusting banks, turned to FinTechs for their banking needs.[30] The "perfect storm" created by this confluence of events is largely credited as having launched fintech into widespread popularity.[31] While this is somewhat true of modern fintech consumption, the industry itself has been revolutionizing the American banking industry for more than a century.

Indeed, in 1865, Giovanni Caselli invented the pantelegraph, which was used primarily to verify signatures in banking transactions.[32] One year later, the Atlantic Telegraph Company laid the first transatlantic telegraph cable, shortening the flow of information between financial markets in New York and London from two weeks to just a few minutes.[33] These innovations stand as the genesis of financial and economic globalization—two paradigmatic shifts for which technological innovation is responsible.[34]

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26. *See* Howell, *supra* note 2, at 23.

27. Douglas W. Arner, Janos Barberis & Ross P. Buckley, *The Evolution of FinTech: A New Post-Crisis Paradigm*, 47 GEO. J. INT'L L. 1271, 1286 (2016).

28. *See generally* MARC LABONTE, CONG. RSCH. SERV., R42150, SYSTEMICALLY IMPORTANT OR "TOO BIG TO FAIL" FINANCIAL INSTITUTIONS 18 (2018).

29. Arner et al., *supra* note 27, at 1289.

30. "For example, the level of trust Americans have in Citibank is thirty-seven percent, while trust in Amazon and Google is seventy-one percent and sixty-four percent respectively. Beyond well-established corporations . . . there is an increasing number of non-listed companies and young start-ups that are handling customers' money and financial data." *Id.* at 1286.

31. *See id.* at 1273.

32. Eilene Zimmerman, *The Evolution of Fintech*, N.Y. TIMES (Apr. 6, 2016), https://www.nytimes.com/2016/04/07/business/dealbook/the-evolution-of-fintech.html.

33. Arner et al., *supra* note 27, at 1274.

34. *Id.*

Less than a century later, Bank of America leveraged technology to tackle a new challenge. As one of the world's largest banks, with more than 4.6 million accounts under its management in 1951, Bank of America found its continued growth was limited significantly by its inability to adequately service accounts.[35] At the time, bookkeepers were required to record by hand each check drawn on or deposited into customer accounts.[36] This process was highly labor-intensive and meant an experienced bookkeeper could post an average of 245 checks per hour, about 2,000 a day, and approximately 10,000 per week—a number far too low to sustain a bank adding nearly 23,000 new checking accounts to its books each month.[37] Bank of America responded to these concerns by establishing a first-of-its-kind partnership with the Stanford Research Institute—an industry pioneer in technology research and innovation.[38] Less than five years later, the two companies unveiled the world's first computer-based check-processing system, and the financial services industry was again revolutionized by technology.[39]

As Bank of America heralded the beginnings of contemporary digital banking, Chemical Bank, later subsumed by J.P. Morgan Chase, followed its lead by installing the United States' first automated teller machine (ATM) in Rockville Centre, New York, in 1969.[40] Paul Volcker, the twelfth chairman of the Federal Reserve, famously quipped that the ATM was "the most important financial innovation" in recent history.[41] At the time, these machines were merely cash dispensers, allowing users to withdraw funds from their accounts without visiting a bank's physical location. Half a century later, the network of ATMs has grown to more than three million locations worldwide, with service offerings far beyond their one-trick predecessors.[42]

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35. James L. McKenney, Richard O. Mason & Duncan G. Copeland, *Bank of America: The Crest and Trough of Technological Leadership*, 21 MGMT. INFO. SYS. Q 1, 322 (1997).

36. *Id.* at 322–23.

37. *Id.* at 322; *Banking Automation: ERMA*, SRI INT'L, https://www.sri.com/hoi/banking-automation-erma/ (last visited Mar. 10, 2023).

38. McKenney et al., *supra* note 35, at 324.

39. *Id.* at 328. Interestingly, although it weighed 25 tons and occupied 400 square feet, Bank of America's new check automation system allowed nine bookkeepers to accomplish the same volume of work that previously required fifty employees. *See id.* at 351–52 n.9.

40. *This Day in History: First ATM Opens for Business*, THE HIST. CHANNEL (Nov. 24, 2009), https://www.history.com/this-day-in-history/first-atm-opens-for-business. Two years earlier, Barclays bank unveiled the world's first ever ATM, which it named the "robot cashier," at a branch location in Enfield, north London. *See* Zimmerman, *supra* note 32.

41. *See* Eric Schurenberg, *Eight Financial Innovations to Believe In*, CBS NEWS (Dec. 18, 2009), https://www.cbsnews.com/news/eight-financial-innovations-to-believe-in/ (quoting Paul Volcker's speech at the December 2009 Future of Finance Initiative).

42. *The History of ATM Innovation*, NCR CORP. (Jan. 12, 2021), https://www.ncr.com/blogs/banking/history-atm-innovation. Banks continue adding to ATMs new and innovative features that have increased access to financial products and make the lives of consumers easier. One exciting addition is the Crypto ATM, which enables users to purchase cryptocurrencies, such as Bitcoin or Ethereum, directly from the terminal using a bank card or cash. *See* David Thorne, *What Is a Cryptocurrency ATM And How Does It Work?*, ENTREPRENEUR (Oct. 1, 2020), https://www.entrepreneur.com/en-au/news-and-trends/what-is-a-cryptocurrency-atm-and-how-does-it-

Each stage of the American banking industry's history demonstrates the interlinkage of finance and technology, as well as the industry's pliancy throughout time and innovation. They are similarly representative of the increasingly complex challenges faced by market participants and their regulators. However, what distinguishes earlier generations of FinTechs from their newest iteration is the industry's target customer.[43] Prior to the 2008 financial crisis, FinTechs marketed their services mostly to financial institutions.[44] Modern FinTech firms have, in many ways, cut out these middlemen and now deal directly with end-users.[45] Disintermediating retail finance comes with a number of benefits to consumers and competition, but at the same time, it has the potential to undermine the regulatory infrastructure built to prevent banks and similar financial institutions from propagating risk within the economy.[46] BaaS is the newest example of this regulatory sidestepping.

A. BAAS DISINTERMEDIATES THE PROVISION OF BANKING PRODUCTS

BaaS is a newly minted partnership model further connecting FinTech firms to federally-chartered banking institutions, with a market size expected to exceed $51 billion by 2028.[47] While BaaS finds its beginnings prior to 2020, it was the COVID-19 pandemic that steered the financial services industry toward a pivotal crossroads: incumbent players could keep pace with demands for digital transformations, or they could retain their legacy IT systems and risk disruption by technology-savvy competitors.[48] For the former group, the path was clear—it maintained focus on customer-centric operations by partnering with FinTech firms. However, altruism is a virtue rarely found among the United States' network of financial institutions. Rather, BaaS partnerships provide banks with a means to assuage fears of

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work/357028. Another ATM variation on the rise allows consumers caught without their credit or debit cards to use their phones to obtain funds by keying in a unique code at the ATM terminal. *See* Craig Guillot, *The ATM of the Future Will Be Much More Personalized*, THE FIN. BRAND (Dec. 13, 2021), https://thefinancialbrand.com/news/banking-branch-transformation/atm-of-the-future-more-personalized-itm-mobile-126398/.

43. Arner et al., *supra* note 27, at 1275–76.

44. *Id.* at 1276.

45. *Id.*

46. *See* U.S. DEP'T OF THE TREASURY, ASSESSING THE IMPACT OF NEW ENTRANT NON-BANK FIRMS ON COMPETITION IN CONSUMER FINANCE MARKETS 3–6 (2022). While there is evidence that FinTechs are enhancing consumer finance, such as by providing "expanded access to credit through alternative approaches to underwriting," these firms may also "pose risks by engaging in harmful regulatory arbitrage, conducting activities in a manner that inappropriately sidesteps safety and soundness and consumer protection law requirements." *Id.* at 3–4.

47. *Banking as a Service: Predictions for 2023*, FINEXTRA 4 (Oct. 2022), https://www.finextra.com/finextra-downloads/research/documents/259/banking-as-a-service-predictions-for-2023.pdf; *Banking-as-a-Service Market Size Worth $51.2 billion by 2028*, KBV RSCH. (Oct. 28, 2022), https://www.kbvresearch.com/banking-as-a-service-market/.

48. FINEXTRA, *supra* note 47, at 3–5.

obsolescence, which FinTechs themselves have had a hand in provoking.[49] On the other side, FinTech firms receive nearly unfettered access to federally regulated banking products—an advantage that would otherwise cost not only an exorbitant fee but also significant amounts of time and autonomy.[50] Along with a reconfigured value chain, this newfound symbiosis brings with it a seemingly endless supply of disintermediated banking products.[51] Provision of these products is accomplished on a "white label" basis, where the regulated financial products and services are embedded directly into the FinTech's platform using the bank's existing IT systems and other integration methods.[52]

White labeling is a practice found in many industries outside of financial services.[53] To summarize the process, a product or service is produced by one company, "Company A," and sold to another company, "Company B," which will rebrand the good and market it to consumers as though Company B was its original manufacturer.[54] Businesses utilize this model primarily to reduce or eliminate the costs of bringing a new product to market while simultaneously deepening customer engagement, diversifying revenue sources, and enhancing trademark recognition.[55] However, BaaS provides an alternative take on this arrangement.

In a BaaS partnership, the FinTech assumes the role of Company B and is responsible for building, designing, and marketing the financial services it offers to consumers.[56] The bank partner will ultimately execute these services, but the end-user might never discover the bank's behind-the-scenes involvement.[57] To do this, the chartered bank provides their counterparts with an "end-to-end package of financial processes, operations, and application programming interfaces (APIs) connectivity."[58] These APIs are the foundation on which a successful BaaS partnership is built.

Application programming interfaces are the essential links connecting the FinTech's user interface to the bank's catalog of financial services.[59] "APIs are software interfaces that enable different systems and applications

49. *See supra* notes 26–31 and accompanying text (discussing shift in retail finance consumers' preferences following the 2008 financial crisis).

50. de Backer et al., *supra* note 3, at 2.

51. *See id.*

52. Coeurderoy & Guilhon, *supra* note 11, at 2.

53. Carla Tardi, *White Label Product*, INVESTOPEDIA (Nov. 29, 2022), https://www.investopedia.com/terms/w/white-label-product.asp (noting white label products can be found in businesses such as retailers (e.g., Walmart, Whole Foods), electronics companies, and branded credit cards (e.g., L.L. Bean by Barclays, Macy's by American Express)).

54. *Id.*

55. Shelagh Dolan, *Why Private Label Banking Apps and Financial Services Are Growing in 2022*, INSIDER INTEL. (Apr. 15, 2022), https://www.insiderintelligence.com/insights/private-white-label-banking/.

56. de Backer et al., *supra* note 3, at 2.

57. *Id.*

58. *Id.*

59. *Id.*

to talk to each other and share processing and data . . . without requiring additional infrastructure."[60] For example, imagine a chain containing three links—the first and third are not connected directly but are nonetheless tethered to the other by the second link. This center link is similar to the functionality provided to BaaS partnerships through the use of an API; it allows the FinTech's user interface to gain access to the bank's IT infrastructure and provide financial services to consumers under the FinTech's name.[61] Notably, APIs are entirely customizable and can be built with an unlimited number of microservices that connect the two IT systems.[62] Designing platforms around this architecture inspires new opportunities, such as heightened operational efficiencies and improved user experience.[63]

Once a BaaS API is configured, the FinTech partner embeds into its digital platform the desired financial products that are pushed out to consumers when and where they are needed.[64] From there, users can access and use those services without ever leaving the FinTech's app or website.[65] An example of an embedded BaaS product is the "Apple Card" (the Card), the implications of which are further discussed below in Section II(C).[66]

Apple introduced its aptly named Apple Card in August 2019.[67] Customers seeking to apply for the Card can do so through the "Wallet" app found in each iPhone "and start using it right away."[68] Although Apple markets the Card as "created by Apple, not a bank," the tech giant enlisted Goldman Sachs to formulate the Card's credit policy and underwriting decisions as well as oversee its management program and customer service

60. Enrico Camerinelli, *Open Bank, APIs, and Financial Services Ecosystems: The Future of Banking*, AITE GRP. 6 (July 2017), https://www.softwareag.com/corporate/images/Aite_Group_Open_bank_api_and_financial_services_Research_Jul17_tcm389-167453.pdf.

61. de Backer et al., *supra* note 3, at 2.

62. "Microservices" is a term that describes the software programming technique in which "a single application is composed of many loosely coupled and independently deployable smaller services." Microservices facilitate easier scaling and development of API functionalities, enabling architects to introduce new products more rapidly. IBM Cloud Education, *What are Microservices?*, IBM (Mar. 30, 2021), https://www.ibm.com/cloud/learn/microservices; *see also* FINEXTRA, *supra* note 47, at 9.

63. *See* Kanika Hope, *Want to Harness the Power of BaaS?,* TEMENOS (July 18, 2022), https://www.temenos.com/news/2022/07/18/want-to-harness-the-power-of-baas-then-modernize-your-core-with-cloud-and-api/.

64. *Id.*

65. *Id.*

66. *See* discussion *infra* Section II(C). For additional information about the Apple Card, see *About*, APPLE, https://www.apple.com/apple-card/ (last visited Mar. 10, 2023). In sum, technology tycoon Apple is offering a co-branded credit card powered by BaaS partnerships with Goldman Sachs and Green Dot Bank.

67. *Apple Card Launches Today for All U.S. Customers*, APPLE (Aug. 20, 2019), https://www.apple.com/newsroom/2019/08/apple-card-launches-today-for-all-us-customers/.

68. *Id.*

activities.[69] Going even further, Apple announced in October 2022 that Apple Card holders will be able to deposit cash directly into a high-yield savings account hosted by Goldman Sachs.[70] Thus, in integrating the Apple Card's application and key functions directly into the iPhone's native apps, Apple utilizes APIs to connect Goldman's credit-approval, banking, and management systems to its own interface. Moreover, Apple Card users can pay their balance and accept and use cashback rewards right from their iPhones without ever interacting with Goldman Sachs.[71]

Although Goldman Sachs is generally recognized among the monolithic institutions that control the United States financial services industry, it is important to note that BaaS partnerships are more commonly found among small community banks. Unlike Goldman Sachs, which held nearly $2.5 trillion under its control in 2021, community banks carry assets totaling less than $10 billion.[72] The difference in size between community banks and global financial institutions results in the former's inherent vulnerabilities to increased market competition.[73] A 2020 study released by the FDIC quantified these susceptibilities, stating that "small businesses were 12 percentage points more likely to receive financing through a FinTech or online lender in 2018 than in 2016, with a nearly equal decline in the likelihood of borrowing from a bank lender."[74]

B. THE REGULATORY PERIMETER DOES NOT EXTEND TO BAAS-GENERATED RISKS

The looming gap in regulatory authority over BaaS partnerships has become a pressing issue among regulators in the United States. In September

69. *See Apple Card Support*, APPLE, https://support.apple.com/apple-card (last visited Mar. 10, 2023) (providing a hyperlink for users experiencing issues with Apple Card to "contact an Apple Card Specialist at Goldman Sachs").

70. *Apple Card Will Soon Let Users Grow Daily Cash Rewards While Saving for the Future*, APPLE (Oct. 13, 2022), https://www.apple.com/newsroom/2022/10/apple-card-will-let-users-grow-daily-cash-rewards-while-saving-for-the-future/.

71. Dave Johnson, *'How Does the Apple Card Work?': A Guide to Using Apple's New Credit Card and Its Features*, BUS. INSIDER (Sept. 29, 2020, 5:35 PM), https://www.businessinsider.com/guides/tech/how-does-apple-card-work.

72. The Goldman Sachs Grp., Inc., Annual Report (Form 10-K) 75 (Mar. 18, 2022); BD. OF GOVERNORS OF THE FED. RSRV. SYS., *supra* note 25, at 1 n.1. In a September 2021 report, the Federal Reserve highlighted growing risks associated with the increasing prevalence of community bank-FinTech partnerships. The report offers a range of challenges and considerations for these institutions to evaluate potential business arrangements. *Id.* at 9–15. Furthermore, while large banks are less likely to rely on the benefits to revenue provided by BaaS partnerships, some have still entered the space. For instance, Goldman Sachs launched its cloud-based platform, TxB, in 2020, and now provides the banking infrastructure for co-branded credit cards offered by nonbank firms across various sectors, including Apple and General Motors. *See* Iulia Ciutina, *Marcus by Goldman Sachs Adds GM as Second Co-Branded Credit Card*, TEARSHEET (Jan. 13, 2022), https://tearsheet.co/payments/marcus-by-goldman-sachs-adds-gm-as-second-co-branded-credit-card/.

73. FED. DEPOSIT INS. CORP., FDIC COMMUNITY BANKING STUDY 6-15–17 (2020).

74. *Id.* at 6–12.

2022, Michael Hsu, Acting Comptroller of the Currency, announced the OCC's plans to further investigate BaaS partnerships and the ways they have materially altered banking's risk profile.[75] Specifically, these concerns relate to the Bank Secrecy Act, Anti-Money Laundering, and Know Your Customer compliance standards.[76] To address these changes, Hsu stated the OCC is "working on a process to subdivide bank-FinTech arrangements into cohorts with similar safety and soundness risk profiles and attributes" that will provide much-needed clarity on the agency's risk management expectations.[77] Hsu emphasized the "nagging familiarity" he has identified with trends toward commodifying and digitizing banking services and the complex relationships underlying the 2008 financial crisis.[78] "If left to its own devices," he says, the de-integration of banking services "is likely to accelerate and expand until there is a severe problem or even a crisis."[79] Hsu's comments make certain that regulatory action is imminent, although the specific measures are yet to be determined. Meanwhile, the OCC has demonstrated that it will continue exercising its authority over those BaaS partners it can control—banks.

Just one week prior to Hsu's address, a Securities and Exchange Commission (SEC) Form 8-K filing revealed that the OCC ordered Virginia-based Blue Ridge Bank to overhaul its compliance practices with regard to third-party FinTech partnerships.[80] According to the agreement, Blue Ridge, which holds approximately $2.8 billion in total assets, must design and implement "a written program to effectively assess and manage the risks posed by third-party FinTech relationships" as well as "obtain an OCC non-objection prior to onboarding or signing a contract with a new third-party FinTech partner, or offering new products or services or conducting new activities with or through existing third-party FinTech partners."[81] The filing does not mention which of Blue Ridge's FinTech partners was the source of controversy.[82] However, commentators speculate that the OCC became aware of the bank's "inability to adequately oversee its sprawling FinTech partnerships" during a review related to the bank's attempted merger in

75. Michael J. Hsu, Comptroller, Off. of the Comptroller of the Currency, Remarks at the TCH + BPI Annual Conference: "Safeguarding Trust in Banking: An Update" (Sept. 7, 2022).

76. Michael Taiano et al., *US Bank Regulators Tighten FinTech Access to Bank Charters, Funding*, FITCH RATINGS (Oct. 27, 2022, 8:13 AM), https://www.fitchratings.com/research/banks/us-bank-regulators-tighten-fintech-access-to-bank-charters-funding-27-10-2022.

77. Hsu, *supra* note 75.

78. *Id.*

79. *Id.*

80. *See* Dan Ennis, *OCC Orders Blue Ridge Bank to Bolster FinTech Partnership Oversight*, BANKING DIVE (Sept. 2, 2022), https://www.bankingdive.com/news/occ-orders-blue-ridge-bank-bolster-fintech-partnership-oversight-aml-it-risk/.

81. Blue Ridge Bankshares, Inc., Current Report (Form 8-K) (Aug. 29, 2022). *See supra* notes 72–74 and accompanying text (defining community banks and discussing their incentives to enter into BaaS partnerships).

82. *See* Blue Ridge Bankshares, Inc., Current Report (Form 8-K) (Aug. 29, 2022).

2021.[83] There has been further conjecture on the effects this agreement will have on future BaaS partnerships, with some suggesting its terms might offer insight into "how the OCC would like to see its guidance on managing FinTech partnership risks translated into banks' compliance practices."[84]

The OCC is not alone in its fight against BaaS-generated risks. In August 2021, the OCC, Federal Reserve, and FDIC issued a joint report detailing legal and regulatory compliance risks identified in proliferating bank partnerships with FinTech companies.[85] The publication is intended as a resource for community banks to reference when considering prospective relationships with FinTech companies.[86] While using the guide is voluntary, the agencies highlighted six areas where increased attention during due diligence may be appropriate: (1) business experience and qualifications; (2) financial condition; (3) legal and regulatory compliance; (4) risk management and controls; (5) information security; and (6) operational resilience.[87] While the publication does not affect preexisting supervisory guidance for bank-FinTech relationships, it underscores the growing scrutiny of BaaS partnerships and their risk management practices.[88]

The CFPB has similarly indicated its intention to begin monitoring financial technology firms more closely. In April 2022, CFPB Director Rohit Chopra revealed that the agency would invoke a "largely unused legal provision" of the Dodd-Frank Act to scrutinize nonbank financial companies "whose activities the CFPB has reasonable cause to determine pose risks to consumers."[89] Alongside this announcement, the Bureau released a

83. *See, e.g.*, Jason Mikula, *With Blue Ridge's OCC Agreement, BaaS 'Rumors' Spill Into Public View*, FINTECH BUS. WKLY. (Sept. 4, 2022), https://fintechbusinessweekly.substack.com/p/with-blue-ridges-occ-agreement-rumors; Ennis, *supra* note 80; Jonathan L. Pompan et al., *Bank Provider of BaaS Dinged by OCC; Blueprint for Fintech Partnerships?*, VENABLE LLP (Sept. 13, 2022), https://www.venable.com/insights/publications/2022/09/bank-provider-of-baas-dinged-by-occ-blueprint; Keith Noreika & Brandon Small, *Office of the Comptroller of the Currency Orders Blue Ridge Bank to Improve its Third-Party Risk Management*, PATOMAK GLOB. PARTNERS (Nov. 3, 2022), https://patomak.com/2022/11/03/office-of-the-comptroller-of-the-currency-orders-blue-ridge-bank-to-improve-its-third-party-risk-management/.

84. Pompan et al., *supra* note 83. The guidance referred to is the joint publication issued in August 2021 by the OCC, Federal Reserve, and FDIC. *See* BD. OF GOVERNORS OF THE FED. RSRV. SYS. ET AL., CONDUCTING DUE DILIGENCE ON FINANCIAL TECHNOLOGY COMPANIES: A GUIDE FOR COMMUNITY BANKS (2021).

85. BD. OF GOVERNORS OF THE FED. RSRV. SYS. ET AL., *supra* note 84.

86. *Id.* at 1.

87. *Id.* Still, the agencies caution that these considerations are not to be understood as exhaustive, and banks may "choose to supplement or augment their due diligence efforts" where appropriate. *Id.* at 2.

88. *See id.* ("Use of this guide is voluntary and it does not anticipate all types of third-party relationships and risks.").

89. *CFPB Invokes Dormant Authority to Examine Nonbank Companies Posing Risks to Consumers*, CONSUMER FIN. PROT. BUREAU (Apr. 25, 2022), https://www.consumerfinance.gov/about-us/newsroom/cfpb-invokes-dormant-authority-to-examine-nonbank-companies-posing-risks-to-consumers/. Section 1002(26) of the Dodd-Frank Wall Street Reform and Consumer Protection Act defines a "service provider" as "any person that provides a material service to a covered person in connection with the offering or provision by such covered person of a consumer

procedural rule, noting "a public interest in transparency when it comes to these potentially significant rulings," to which it responded by authorizing itself to publish decisions following an investigation into the risks a nonbank financial company poses to consumers.[90] This strapping expansion of the CFPB's regulatory oversight may have far-reaching implications for BaaS participants faced with public enforcement actions, although much will depend on the dynamism with which the agency exercises its newfound enforcement powers.[91]

II. REGULATORS' ILL-FATED ATTEMPTS TO CONTROL BAAS PARTNERSHIPS

Along with new opportunities for innovation, the profusion of fintech-enabled financial services brings with it new regulatory challenges. "[T]he flourishing of fintech depends on whether non-banking players . . . fall under regulatory oversight and, in turn, are subject to heavy bank-like prudential regulation."[92] Indeed, the success enjoyed by these firms is due not only to advancing technologies but also to the extent such firms are able to exploit the systemic dysfunctions plaguing the United States' financial regulatory framework.[93] Simply put, FinTech firms' operations are rarely within the purview of regulators, but when they are, opportunities for regulatory arbitrage are made possible by a fragmented network of agencies "with gaps in authority, overlapping authority, and duplicative authority."[94] Despite this disjointed understanding of fintech's position along the regulatory perimeter, federal and state agencies are taking steps where they can toward restoring the financial marketplace's equilibrium.

A. OCC SAYS BANK-FINTECH PARTNERSHIPS ARE "HERE TO STAY"

The OCC continues to prioritize bank-FinTech partnerships in its regulatory initiatives. Most notably, the agency announced in December

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financial product or service." This provision grants the CFPB authority to exercise jurisdiction over service providers that violate various consumer protection laws—such as the Fair Credit Reporting Act—fair lending laws, or those engaging in unfair, deceptive, or abusive acts or practices. *See* Heather Egan Sussman et al., *What Fintech and Digital Marketing Companies Need to Know Now About the CFPB's Expanding Jurisdiction*, ORRICK HERRINGTON & SUTCLIFFE LLP (Aug. 26, 2022), https://www.orrick.com/en/Insights/2022/08/What-Fintech-and-Digital-Marketing-Companies-Need-to-Know-Now-About-CFPBs-Expanding-Jurisdiction.

90. *See* 12 C.F.R. § 1091.115(c)(2) (2022).

91. As of early 2023, the CFPB has not released any information related to FinTech investigations.

92. Oscar Borgogno & Antonio Manganelli, *Financial Technology and Regulation: The Competitive Impact of Open Banking*, 5 MKT. & COMPETITION L. REV. 105, 108 (2021).

93. *See id.*

94. MARC LABONTE, CONG. RSCH. SERV., R44918, WHO REGULATES WHOM? AN OVERVIEW OF THE U.S. FINANCIAL REGULATORY FRAMEWORK 2 (2020); Borgogno & Manganelli, *supra* note 92, at 108.

2016 that it would begin exploring its authority to "grant[] a special purpose national bank charter to a FinTech company" (FinTech Charter).[95] A year and a half later, in July 2018, the OCC issued a report detailing its findings and alerting firms that it would begin accepting FinTech Charter applications.[96] Because they are federally issued, these Charters would provide the same advantages enjoyed by national banks—namely, preemption of state licensing and consumer financial laws.[97] According to the OCC, "uniform supervision over national banks, including FinTech companies, will help promote consistency in the application of laws and regulations across the country."[98]

A national charter appears as a relatively easy avenue through which regulators can address bank-FinTech risks and questions of institutional stability, all while luring these enigmatic firms into the regulatory framework.[99] Yet, the FinTech Charter might not achieve the breakthroughs for which it was designed. "[F]inTechs chartered under a special purpose charter would not qualify for insurance coverage by the Federal Deposit Insurance Corporation"—a feature militating against a firm's incentive to undertake the capital expenditures required to obtain licensing.[100] As interest rates rise and credit spreads on secured and unsecured debt widen, the ability to accept proprietary deposits both lowers the cost of capital used in originating loans and affords FinTechs a fighting chance against traditional banks.[101] Instead, a firm wishing to offer these services would be required to seek a full-service national bank charter.[102] Moreover, BigTech players, such as Google and PayPal, have reported "exploratory conversations" with the OCC but ultimately decided against pursuing the FinTech Charter.[103] Neither company commented publicly on their reasonings, though it is believed that fears of endangered relationships with state-level regulators might have been

95. OFF. OF THE COMPTROLLER OF THE CURRENCY, EXPLORING SPECIAL PURPOSE NATIONAL BANK CHARTERS FOR FINTECH COMPANIES 2 (2016).

96. OFF. OF THE COMPTROLLER OF THE CURRENCY, POLICY STATEMENT ON FINANCIAL TECHNOLOGY COMPANIES' ELIGIBILITY TO APPLY FOR NATIONAL BANK CHARTERS (2018).

97. *Id.* at 2.

98. *Id.*

99. *See id.*

100. Jennifer Myers & John Runte, *OCC Announces National Bank Charter for FinTech Companies*, BAKER TILLY (Nov. 7, 2018), https://www.bakertilly.com/insights/occ-announces-national-bank-charter-for-fintech-companies. The OCC has offered FinTech firms considering the FinTech Charter a resource to help them understand the necessary steps involved in the application process, though it is based on the already established procedures for national bank charter applications. In summary, there are four phases: (1) prefiling, (2) filing, (3) review, and (4) decision. *See* OFF. OF THE COMPTROLLER OF THE CURRENCY, CONSIDERING CHARTER APPLICATIONS FROM FINANCIAL TECHNOLOGY COMPANIES 3–4 (2018).

101. *See* Taiano et al., *supra* note 76.

102. *See* Myers & Runte, *supra* note 100.

103. *PayPal, Google Give OCC's Bank Charter The Cold Shoulder*, PYMNTS.COM (June 17, 2019), https://www.pymnts.com/news/b2b-payments/2019/occ-bank-charter-legal-disputes-paypal-google/.

the impetus behind their decisions to forgo federal licensing.[104] In addition to these weakened incentives for obtaining a FinTech Charter—as well as the fact that one has yet to be issued—the OCC has been encumbered by a number of legal roadblocks throughout the process.[105]

Among the OCC's challengers, both states and existing community banks have expressed their immediate dissatisfaction with the agency's plan.[106] The New York Department of Financial Services (DFS) maintains a determined opposition to the agency's authority to issue national banking charters to non-depository institutions, having filed multiple lawsuits in federal court.[107] According to the state regulator, the proposed FinTech Charter exceeds the OCC's jurisdiction under the National Bank Act because the "business of banking," as the phrase is used in the Act, requires national banks to accept account-holder deposits.[108] Nevertheless, DFS has been overcome with issues of standing and other procedural barriers, preventing the merits of its claims from being heard by the district court.[109] Only one of these lawsuits has made it past the pleading stage, though this small victory was later overturned by the Second Circuit.[110] As for community banks, the Independent Community Bankers of America (ICBA) argues that a FinTech Charter "would create an unlevel regulatory playing field."[111] The ICBA claims it would be unfair to afford FinTechs with the benefits provided by a national banking charter because "they have not experienced a serious economic downturn" and "they have been subject to serious funding and

104. *Id.*

105. While a FinTech Charter has yet to be issued, the OCC announced in a January 2022 press release its conditional approval for Social Finance, a financial technology company, to form SoFi Bank. Under this agreement, SoFi did not receive a new charter but instead subsumed Golden Pacific, NA, an already-existing national bank insured by the FDIC. Consequently, Golden Pacific underwent a name change, and Social Finance gained the benefits provided by a federal banking charter. *See* Off. of the Comptroller of the Currency, OCC Decision Letter to Conditionally Approve SoFi Bank, National Association, (Jan. 18, 2022), https://www.occ.gov/news-issuances/news-releases/2022/nr-occ-2022-4a.pdf.

106. Maria T. Vullo, DFS Superintendent, argued that the agency's decision to allow FinTech companies to apply for a Special Purpose National Bank Charter is a "lawless" and "ill-conceived" move that will destabilize financial markets more effectively regulated by the state. *See* Complaint for Declaratory and Injunctive Relief ¶ 2, Vullo v. Off. of the Comptroller of the Currency, 378 F. Supp. 3d 271 (S.D.N.Y. 2019) (No. 1:17-CV-03574).

107. *See* Vullo v. Off. of the Comptroller of the Currency, No. 17 Civ. 3574 (NRB), 2017 WL 6512245 (S.D.N.Y. Dec. 12, 2017) (granting the OCC's Rule 12(b)(1) motion to dismiss for lack of subject matter jurisdiction); Vullo v. Off. of the Comptroller of Currency, 378 F. Supp. 3d 271 (S.D.N.Y. 2019), *rev'd and remanded sub nom*. Lacewell v. Off. of the Comptroller of the Currency, 999 F.3d 130 (2d Cir. 2021).

108. Complaint for Declaratory and Injunctive Relief, *supra* note 106, at ¶ 4 (discussing the National Bank Act, 12 U.S.C. §§ 21–216).

109. Lacewell v. Off. of the Comptroller of the Currency, No. 18 Civ. 8377 (VM), 2019 WL 6334895 (S.D.N.Y. Oct. 21, 2019).

110. The Second Circuit reversed the lower court's ruling, finding DFS lacked Article III standing to sue and that its claims were constitutionally unripe. *See Lacewell*, 999 F.3d at 130.

111. Chris Cole, *FinTech Charter*, INDEP. CMTY. BANKERS OF AM., https://www.icba.org/our-positions-a-z/fintech-charter (last visited Mar. 10, 2023).

capital difficulties."[112] Though its arguments are weak, the ICBA's apprehension is supported by historical trends favoring FinTech firms. A 2020 study released by the FDIC found that one out of every ten consumers actively seeking a loan or other form of institutional financing was more likely to obtain it from a FinTech or online lender than from a community bank.[113]

While the future of the FinTech Charter remains unclear, it nevertheless represents an attempt to steer unregulated firms into the purview of federal banking regulators. Until more is known, the effect had on BaaS partnerships will remain minimal. FinTech firms will retain unfettered access to regulated banking products, and their regulated partners will continue to balance the risks and benefits of the partnership.[114]

B. THE FDIC'S EMPTY PROMISE OF DEPOSIT INSURANCE FOR FINTECHS

A federally issued banking charter is not the sole option available to FinTech firms seeking to offer their own proprietary banking products and services directly to consumers. Indeed, these firms have been increasingly drawn to the financial regulatory framework by the FDIC's industrial loan company (ILC) charters. ILCs are state-chartered depository institutions that carry FDIC insurance protections, which subjects them to the joint supervision of the FDIC and the charter-issuing state's banking regulator.[115] ILCs generally offer a limited catalog of financial services, such as deposit products, a range of commercial and consumer loans, and other banking services.[116] However, the ILC charter's primary appeal lies in its exemption from regulation by the Federal Reserve with regard to permissible activities or investments, reporting, examination, or mandatory capital requirements, among other conditions imposed by the Bank Holding Company Act (BHCA).[117] In other words, possession of an ILC charter "allow[s] both financial *and commercial companies* to own and control industrial banks."[118] Extending to these nonbank entities the authority to accept deposits, therefore, eliminates the basis on which DFS continues to challenge the

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112. *Id.*

113. FED. DEPOSIT INS. CORP., *supra* note 73, at 6–12.

114. *See* Howell, *supra* note 2, at 14 (noting FinTechs' incentives to "tap into the regulated sector for the bare minimum of activities" and chartered institutions' incentives to "'push out' new fintech services into unaffiliated firms").

115. Parent Companies of Industrial Banks and Industrial Loan Companies, 80 Fed. Reg. 10,703, 10,704 (Apr. 1, 2021) (codified at 12 C.F.R. pt. 354). Note, however, that despite having existed for more than a century, ILCs were not eligible for FDIC insurance until 1982. *See* Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982) (codified as amended in scattered sections of 12 U.S.C.).

116. *See* Parent Companies of Industrial Banks and Industrial Loan Companies, 80 Fed. Reg. at 10,705.

117. *See id.* at 10,706.

118. *Id.* at 10,703 (emphasis added).

OCC's proposed FinTech Charter.[119] But, despite being federally insured, these institutions must be chartered in one of the limited number of states authorized to do so, further restricting the ILC charter's availability.[120] Among the states with ILCs currently chartered are California, Hawaii, Minnesota, Nevada, and Utah, with Utah attracting by far the majority of commercially owned ILCs.[121]

Still, ILC charters are not unopposed, especially not with regard to the chartering of nonbank companies. In 2005, Walmart, one of the United States' largest retailers, garnered significant attention when it sought approval to establish a Utah-based ILC.[122] More than 13,000 comment letters were sent to the FDIC in response, with most opposing the application.[123] One year later, similar concerns were expressed when Home Depot, another retail giant, submitted to the FDIC a change in control notice in connection with its proposed acquisition of a Utah-chartered ILC.[124] Both applications were ultimately withdrawn due to "widespread objections related to fears that large retailers would exercise anticompetitive market power."[125] Pressure to evaluate the public's and Congress' concerns led to two official moratoria on ILC approvals, spanning from 2006 to 2008 and from 2010 to 2013.[126] After the second moratorium ended, more than six years passed before a new ILC charter was issued, despite a number of notable FinTech applicants.[127]

In March 2020, the FDIC announced it would be issuing ILC charters to Square, a computer hardware and software retailer involved in electronic payments systems, and Nelnet, an education technology provider.[128] The same day, the FDIC also announced that it was seeking comments on a proposed rule regarding the treatment of applicants seeking to form an ILC

119. *See supra* text accompanying notes 106–14.

120. Parent Companies of Industrial Banks and Industrial Loan Companies, 80 Fed. Reg. at 10,705.

121. *Id.*

122. *See* DAVID W. PERKINS, CONG. RSCH. SERV., R46489, INDUSTRIAL LOAN COMPANIES (ILCS): BACKGROUND AND POLICY ISSUES 10 (2020); *see also* Parent Companies of Industrial Banks and Industrial Loan Companies, 80 Fed. Reg. at 10,706.

123. Parent Companies of Industrial Banks and Industrial Loan Companies, 80 Fed. Reg. at 10,706.

124. "The FDIC received approximately 830 comment letters regarding the notice, almost all of which expressed opposition to the proposed acquisition." *Id.*; *see also* PERKINS, *supra* note 122, at 10.

125. PERKINS, *supra* note 122, at 10.

126. *Id.* at 10–11.

127. *See id.* at 12 (noting applications from "Nelnet, Square, Rakuten, AmeriNat Bank, Interactive Bank, and SoFi, all of which owned and operated nonbank enterprises"). The FDIC reports that in the five years between 2017 and 2021, it "received 12 Federal deposit insurance applications related to proposed industrial banks. Of those, two have been approved, eight have been withdrawn, and two are pending." Parent Companies of Industrial Banks and Industrial Loan Companies, 80 Fed. Reg. at 10,705.

128. *See About Us*, SQUARE, https://squareup.com/us/en/about (last visited Mar. 10, 2023); Nelnet is also engaged in regional internet and works primarily with schools and churches. *See Nelnet Story*, NELNET, https://nelnetinc.com/nelnet-story/ (last visited Mar. 10, 2023).

or to merge with or acquire control of an ILC.[129] That rule was finalized and became effective on April 1, 2021, and it added a number of commitments and restrictions.[130] The new rule provides that where approval of such an application for a nonfinancial company will result in both its control of an FDIC-insured ILC and its exemption from the BHCA, (1) the approval must express certain conditions and commitments, and (2) the nonbank ILC must enter into one or more written agreements with the FDIC.[131]

With this new rule in place—and the FDIC's demonstrated amenability to providing nonbanks with deposit insurance—one might anticipate an increase in the number of ILCs formed or acquired by FinTech firms. Yet, these firms have been largely unsuccessful, with an overwhelming majority of applications being either rejected or withdrawn since the two March 2020 approvals.[132] In fact, not a single ILC applicant has received FDIC approval since the new rule's promulgation. This apparent push by regulators toward gatekeeping regulatory oversight is a move in the wrong direction—especially given that the proliferation of BaaS throughout the financial services industry has made clear that these firms will continue offering banking products despite not having a charter of their own.

C. THE CFPB IDENTIFIES CONSUMER PROTECTION RISKS POSED BY BAAS PLATFORMS

On the consumer protection end, the CFPB has launched an investigation into Goldman Sachs' credit card management practices, of which Apple Card is the largest component.[133] In a quarterly Form 10-Q filed with the SEC, Goldman claims the investigation's focus is on the "application of refunds,

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129. PERKINS, *supra* note 122, at 14.

130. *See* Parent Companies of Industrial Banks and Industrial Loan Companies, 80 Fed. Reg. 10,703 (Apr. 1, 2021) (codified at 12 C.F.R. pt. 354). "Through this final rule, the FDIC is formalizing its framework to supervise industrial banks and mitigate risk to the [Deposit Insurance Fund] that may otherwise be presented in the absence of Federal consolidated supervision of an industrial bank and its parent company." *Id.* at 10,708.

131. *Id.* at 10,708–09; *see also* Bob Jaworksi, *FDIC Adopts Final Rule Regarding ILC Applications*, HOLLAND & KNIGHT LLP (Jan. 22, 2021), https://www.hklaw.com/en/insights/publications/2021/01/fdic-adopts-final-rule-regarding-ilc-applications.

132. Taiano et al., *supra* note 76.

133. *See* Niket Nishant, *Goldman Discloses Probe into U.S. Credit Card Division*, REUTERS (Aug. 4, 2022, 5:59 PM), https://www.reuters.com/business/finance/goldman-discloses-probe-into-us-credit-card-division-2022-08-04/. The CFPB is not the only regulator taking a look at Goldman's role in managing the Apple Card. The New York Department of Financial Services in a March 2021 report discussed its since-concluded investigation into allegations of discrimination against women in the Apple Card's underwriting procedures. *See* N.Y. DEP'T OF FIN. SERVS., REPORT ON APPLE CARD INVESTIGATION (May 2021). "Consumers complained that the Bank, in its underwriting of Apple Card credit card accounts, offered lower credit limits to women applicants and denied women accounts unfairly. These claims, in turn, brought the issue of equal credit access to the broader public." *Id.* at 1. These accusations prompted an "exhaustive review of documentation and data" through which the Department uncovered no evidence of "deliberate or disparate impact discrimination." *Id.* at 2.

crediting of nonconforming payments, billing error resolution, advertisements, and reporting to credit bureaus."[134] However, a more likely culprit is the bank's credit scoring practices.

Indeed, Goldman's same Form 10-Q filing reports that more than 28% of its outstanding credit card loans belong to customers with FICO scores below 660.[135] This significant expansion in subprime lending has resulted in a staggering 2.93% loss rate for the bank, which measures the proportion of an issuer's defaulted credit card balances to its overall outstanding credit.[136] For context, J.P. Morgan and Bank of America, two of Goldman Sachs' largest competitors, reported loss rates during the same period of 1.47% and 1.60%, respectively.[137] Capital One, recognized as the largest subprime big-bank lender, reported a loss rate of 2.26%.[138] Thus, despite efforts to reinvent the wheel, the Apple Card appears to have fallen short of its mark. To make matters worse, the regulatory blowback from these inadequate credit management practices will be borne almost exclusively by Goldman. This disparate treatment is a consequence of regulatory fragmentation: Because Apple is not a financial company over which the CFPB has regulatory authority, the tech giant falls outside its jurisdictional boundaries and cannot be held liable for the Apple Card's shortcomings.

Still, however, Apple has not emerged entirely unscathed. This is understandable given the array of features promised to Apple Card holders.[139]

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134. The Goldman Sachs Grp., Inc., Quarterly Report (Form 10-Q) 98 (June 30, 2022). Interestingly, in the unveiling of its BaaS platform—Transaction Banking (TxB)—Goldman credited its "compliance, regulatory and legal expertise" as a factor inspiring the bank's decision to enter the BaaS market. *See* Luc Teboul, *Why We've Moved Into Banking as a Service*, THE GOLDMAN SACHS GRP., INC., https://www.goldmansachs.com/what-we-do/transaction-banking/news/why-weve-moved-into-banking-as-a-service.html (last visited Mar. 10, 2023).

135. The Goldman Sachs Grp., Inc., Quarterly Report (Form 10-Q) 39 (June 30, 2022). This metric reflects the percentage of Goldman Sachs' total credit card loans ($11.844 billion) that belong to borrowers with FICO scores below 660 ($3.353 billion).

136. Hugh Son, *Goldman's Apple Card Business Has a Surprising Subprime Problem*, CNBC (Sept. 12, 2022, 6:00 AM), https://www.cnbc.com/2022/09/12/goldmans-gs-apple-card-business-has-a-surprising-subprime-problem.html; *see* Chris B. Murphy, *Charge-Off Rate (Credit Card) Definition*, INVESTOPEDIA (Sept. 9, 2022), https://www.investopedia.com/terms/c/chargeoff-rate-credit-card.asp. Note also that subprime lending is generally understood as loans made to borrowers with credit scores falling below 660. *See, e.g.*, *Borrower Risk Profiles*, CONSUMER FIN. PROT. BUREAU (Dec. 2019), https://www.consumerfinance.gov/data-research/consumer-credit-trends/student-loans/borrower-risk-profiles/.

137. *See* Son, *supra* note 136. As of September 30, 2022, the Federal Reserve ranked J.P. Morgan as the largest United States-charted commercial bank, with Bank of America as the second largest and Goldman Sachs as the eighth. THE FED. RSRV., INSURED U.S.-CHARTERED COMMERCIAL BANKS THAT HAVE CONSOLIDATED ASSETS OF $300 MILLION OR MORE, RANKED BY CONSOLIDATED ASSETS (Sept. 2022). Notably, J.P. Morgan reports 12% of its borrowers having FICO scores below 660, while Bank of America reports only 3.7% of its borrowers fall below 630. Son, *supra* note 136.

138. *See* Son, *supra* note 136.

139. When Apple C.E.O. Tim Cook announced the Apple Card in March 2019, he noted the unique opportunity to push the card out to Apple's massive user base. Further, he stated that the

One such feature is Apple Pay Later, which represents Apple's latest BaaS partnership with Mastercard. Apple Pay Later marks the iPhone maker's move into the "Buy Now, Pay Later" (BNPL) loans space.[140] Similar to traditional layaway plans, BNPL is an interest-free payment structure that allows borrowers to make four or fewer installments over a period of six weeks.[141] These new plans differ significantly from their predecessors in that, along with receiving the underlying product, BNPL consumers gain immediate possession of the associated debt liability.[142] Soon after Apple's announcement in June 2022, CFPB Director Rohit Chopra cited antitrust and consumer data protection concerns, stating the agency will take a "very careful look at BigTech's foray into buy now, pay later."[143] "Any tech giant that has a lot of control over a mobile operating system is going to have unique advantages to exploit data and e-commerce more broadly," Chopra continued.[144] Similarly, he questions whether market participants will be able to compete and if merchants have an actual choice as to offering installment plans to their customers.[145]

Considering the substantial digital assets accumulated by companies such as Apple, Amazon, Facebook, and Google, Chopra's concerns are not surprising. Combined with these firms' preeminent data analytics skills, it seems only logical for them to leverage their massive customer bases by bundling banking and financial services with other core branded products.[146] Yet, as the separation between commerce and banking "becom[es] murkier and murkier," the CFPB has taken a stance on tougher enforcement measures by broadening its understanding of evolving consumer protection risks, such as those posed by BigTech's entrance into BaaS.[147] The CFPB's authority to monitor risks to consumers lends the greatest opportunity to level the playing

card would feature no late fees, international fees, overage fees, or annual fees. *Features*, APPLE, https://www.apple.com/apple-card/features/ (last visited Mar. 10, 2023).

140. *What's New in Apple Pay*, APPLE, https://developer.apple.com/apple-pay/whats-new/ (last visited Mar. 10, 2023). Apple Pay Later is one of around eighty BNPL programs available as of late 2022, including Affirm, Afterpay, Klarna, and PayPal. *See Apple's Move Into BNPL Space Triggers Alarm at CFPB*, PYMNTS (July 27, 2022), https://www.pymnts.com/apple/2022/apples-move-into-bnpl-space-triggers-alarm-at-cfpb/.

141. CONSUMER FIN. PROT. BUREAU, BUY NOW, PAY LATER: MARKET TRENDS AND CONSUMER IMPACTS 3 (2022).

142. Ann Carrns, *The Downsides of Using 'Buy Now, Pay Later,'* N.Y. TIMES (Dec. 29, 2022), https://www.nytimes.com/2022/12/29/your-money/buy-now-pay-later-loans.html.

143. Stefania Palma, *Top US Regulator Fires Warning Shot After Apple's Push into Lending*, FIN. TIMES (July 27, 2022), https://www.ft.com/content/399c177f-e5da-491a-b653-afe953bbdce0.

144. *Id.*

145. *Id.*

146. *See* Borgogno & Manganelli, *supra* note 92, at 108.

147. Palma, *supra* note 143; Consumer Fin. Prot. Bureau, Notice and Request for Comment Regarding the CFPB's Inquiry Into Big Tech Payment Platforms (Oct. 31, 2022), https://files.consumerfinance.gov/f/documents/cfpb_notice-regarding-re-opening-comment-period-for-big-tech-payment-platforms_2022-11.pdf.

field between banks and FinTechs, though only time will tell if it too will be stifled into inaction by regulatory encumbrances and bureaucracy.

III. REDEFINED AND RECONFIGURED: A PROPOSED SOLUTION TO MANAGING BAAS-GENERATED RISKS

The pace at which BaaS is expanding has created an increasingly varied and complex set of bank-FinTech arrangements. However, as regulators have struggled to grapple with their inner workings, early attempts at addressing the risks these partnerships pose to consumers and financial markets have been mostly ineffective. This failure can be largely attributed to the fragmented network of regulatory agencies in the United States, which suggests untapped utility is to be found in standardizing the applicable oversight and flow of information to and from the market.[148] This clarity is critical, for its absence disincentivizes innovation and deprives consumers of the benefits that digital services and increased competition can provide.[149] Furthermore, an activity-based approach to regulation offers similar assistance in reforming the process for addressing BaaS partnerships, a secondary effect of which includes reduced opportunities for regulatory arbitrage.[150] Thus, taken as a whole, the aim is to redefine the regulatory perimeter.

Disparate regulatory requirements imposed on BaaS partners can disrupt banks' activities as intermediaries and create dangers to institutional stability.[151] These variations in power also provide opportunities for larger, more capitalized firms to gain an unfair competitive advantage in the market and diminish competition within the financial services industry.[152] To combat these risks, standardized and reliable access to fintech data is crucial for developing adequate regulations. This is the concept used by the Mexican National Banking and Securities Commission (known as "CNBV" by its Spanish acronym) in drafting the Law to Regulate Financial Technology Institutions (Mexican FinTech Law).[153]

Passed in March 2018, the Mexican FinTech Law has helped propel the country to become the largest fintech hub in Latin America.[154] The Law's objective is to protect consumers and foster competition, which it accomplishes by regulating banking agents, entrepreneurs, and private capital

148. LABONTE, *supra* note 94, at 2.

149. *See* Borgogno & Manganelli, *supra* note 92, at 108.

150. Jeremy C. Kress et al., *Regulating Entities and Activities: Complementary Approaches to Nonbank Systemic Risk*, 92 S. CAL. L. REV. 1455, 1525 (2019).

151. Fernando Restoy, *Fintech Regulation: How to Achieve a Level Playing Field*, FIN. STABILITY INST. 2 (Feb. 2021), https://www.bis.org/fsi/fsipapers17.pdf.

152. *Id.*

153. *See Key Aspects around Financial Technologies and Regulation Policy Report*, CTR. FOR LATIN AM. MONETARY STUD. 22 (May 2019), https://www.cemla.org/fintech/docs/2019-06-KeyAspectsAroundFinancialTechandRegulation.pdf.

154. *See generally* Código Civil [CC], Diario Oficial de la Federación [DOF] 03-09-2018 (Mex.).

owners, while also reducing existing barriers to innovation and working to prevent fraud and money laundering.[155] Among the Mexican FinTech Law's many provisions, two stand out as opportunities to aid United States regulators in managing BaaS risks. First is the creation of the Mexican Regulatory Sandbox, which is inspired by earlier initiatives in the United Kingdom.[156] Under the Mexican model, FinTech firms must seek temporary authorization to provide services to a limited number of consumers.[157] This trial period allows companies to test business models in controlled environments while taking the steps required to obtain licensing as a Financial Technology Institution.[158] Back in the United States, such an arrangement would allow regulators to gain a first-hand understanding of the technologies powering BaaS APIs as well as to gain insight into the terms of the partnership agreements underlying bank-FinTech relationships. Moreover, surveilling these safe havens extends additional protections to consumers whose interests would otherwise be at the whim of unmonitored and underregulated service providers.[159]

The second key feature of the Mexican FinTech Law is its open API scheme, which requires financial entities to develop standardized APIs.[160] This model promotes connection and non-discriminatory access to other interfaces and allows industry participants to use aggregated and transactional user data to improve product offerings and financial services.[161] To do so, the entity must first obtain consent from the corresponding regulatory agency and then, in exchange for a fee, request access to the other participant's API.[162] This provision aims to provide regulators with simpler compliance mechanisms and eliminates unnecessary formalities for obtaining access to such data.[163] Transposing these benefits to the United States would enhance connectivity in BaaS partnerships and work towards democratizing access to industry-wide information. By homogenizing the

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155. CTR. FOR LATIN AM. MONETARY STUD., *supra* note 153, at 22.

156. *Id.*

157. *Id.* In terms of financial regulation, a regulatory sandbox is defined as "a framework set up by a financial sector regulator to allow small-scale, live testing of innovations by private firms in a controlled environment under the regulator's supervision." Ivo Jenik & Kate Lauer, *Regulatory Sandboxes and Financial Inclusion*, CONSULTATIVE GRP. TO ASSIST THE POOR (Oct. 2017), https://www.cgap.org/research/publication/regulatory-sandboxes-and-financial-inclusion.

158. CTR. FOR LATIN AM. MONETARY STUD., *supra* note 153, at 22. FinTechs may be further incentivized to enter into a regulatory sandbox based on empirical data indicating that participation is associated with an increase in the average amount of funding raised and a higher probability of raising funding. *See* Cornelli et al., *Regulatory Sandboxes and Fintech Funding: Evidence from the UK* 30 (Bank for Int'l Settlements, Working Paper No. 901, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3727816.

159. *See* CTR. FOR LATIN AM. MONETARY STUD., *supra* note 153, at 22.

160. *Id.*

161. *Id.* at 22–23, 22 n.16.

162. Arturo Pérez-Estrada et al., *FAQs Concerning Mexico's New FinTech Law*, GREENBERG TRAURIG (Apr. 2018), https://www.gtlaw.com/en/insights/2018/4/mexicos-new-fintech-act-faqs.

163. *Id.*

seemingly infinite variations of BaaS platforms, regulators can reduce reaction times and address risks as they arise.

Finally, the core issue preventing adequate regulation of BaaS partnerships is the jurisdictional barriers erected by the current regulatory regime. Under the traditional sectorial approach to financial regulation, requirements are operative only on holders of a specific license or charter.[164] That charter is defined in terms of the activities performed by the underlying entity.[165] However, given fintech's complexity and evolutionary speed, it is clear this one-size-fits-all model threatens to distort competition and stifle innovation.[166] This further incentivizes FinTechs burdened by compliance costs and reduced autonomy to organize their conduct outside the purview of regulators.[167] Thus, a new framework has emerged under which rules apply to all institutions engaged in a particular service. This activity-based approach to FinTech regulation ensures that regulations are adaptable and will remain comprehensive without being changed repeatedly, thereby reducing existing opportunities for regulatory arbitrage.[168]

Still, entity- and activity-based approaches to BaaS regulation do not have to be exclusive. In fact, these partnerships inspire an opportunity for a hybrid approach, where an agency tasked solely with maintaining the stability of the United States' financial markets would promulgate rules across the entire industry to be applied by existing regulators to their respective sectors.[169] A similar regime is contemplated by the Mexican FinTech Law, which provides for the creation of a Financial Innovation Group (FIG).[170] The FIG, comprised of representatives from both the public and private sectors, aims to allow adaptive service-based regulations to complement principled entity-based regulations through an open exchange of knowledge about fintech innovations.[171] Furthermore, consolidating regulation of systemic financial risks can avoid fragmentation issues that have allowed unregulated firms in the United States to skirt governmental authority.

It should be noted that this approach would be limited significantly by implementation challenges. To perform its role effectively, a consolidated regulator would need access to detailed financial information from across the industry.[172] Likewise, the United States political climate is likely to impose

164. *See* CTR. FOR LATIN AM. MONETARY STUD., *supra* note 153, at 7–8.

165. *Id.*

166. *See id.* at 7.

167. Howell, *supra* note 2, at 13.

168. CTR. FOR LATIN AM. MONETARY STUD., *supra* note 153, at 23.

169. Kress et al., *supra* note 150, at 1519–20.

170. CTR. FOR LATIN AM. MONETARY STUD., *supra* note 153, at 23.

171. *Id.*

172. The Treasury Department has already explored this structure and provided a discussion on its potential advantages and limitations. *See* U.S. DEP'T OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE 141 (2008). "A key advantage of the

significant opposition to such a substantial alteration to the regulatory framework.[173] Despite these bulwarks, BaaS presents a number of threats to consumer protection and financial stability that continue to demonstrate the need for a reformed approach to regulation.[174] To properly account for the evolving risks imposed by BaaS and fintech innovation, this new framework must redefine the regulatory perimeter.

CONCLUSION

As BaaS continues to gain traction throughout the financial services industry, new and unforeseen threats will continue to rear their heads. And as regulators scramble to understand and address the consequences of BaaS partnerships, one overarching question emerges: Who regulates whom? These agencies must grapple with the reality that, as it stands, the labyrinthine network of authority in the United States is no longer equipped to adequately control this new model for providing banking products. Consequently, the inescapable solution is to redefine the regulatory perimeter.

No small feat indeed; American regulators and policymakers may benefit from looking to other countries tasked with accomplishing a similar goal. Mexico's FinTech Law, for example, has provided the country with processes for establishing free-flowing information channels as well as standardized and open-sourced application infrastructures. Though much would need to be adapted to conform to the United States' much larger banking economy, doing so would ensure consumers and the financial services industry are no longer left unguarded against unregulated and profit-driven firms.

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consolidated regulator approach is enhanced efficiency from combining common functions undertaken by individual regulators into one entity." *Id.* This approach, it says, "allows for a clearer view of overall risks to the financial system as one entity would regulate all financial institutions," a benefit which grows in importance "as the size and significance of diversified financial conglomerates rises." *Id.* Most importantly, however, is the Department's recognition that a consolidated regulator would eliminate issues associated with overlapping jurisdictions of individual regulators. *Id.*

173. Kress et al., *supra* note 150, at 1519.

174. *See, e.g.*, *supra* notes 21–24 and accompanying text (discussing threats to consumer and data protection posed by inadequate FinTech regulation).

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