The New Fintech Federalism

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American law has struggled to accommodate the rise of fintech. The United States has labored under a division of regulatory authority between the state and federal governments designed for a financial landscape comprised of banks and large, systemically important shadow banks.

To catch up to the market, state and federal officials have undertaken a diverse array of initiatives. Numerous regulators have relied on the prevailing paradigm of the past century, seeking to extend its already stretched logic into the realm of fintech and exacerbating its many shortcomings in the process. But several regulatory initiatives of the past decade have broken with prior thinking and charted a different path. That path redefines the relative realms of the federal and state governments and promises a legal regime suited to the technological realities of twenty-first century finance.

This emergent paradigm—the New Fintech Federalism—constitutes a radical reversal of the prior division of authority between state and federal actors. Through both cooperative and unilateral initiatives, the states are increasingly adopting an entity-based approach rooted in interstate reciprocity that internalizes the benefits of jurisdictional competition and reduces the costs of redundant mandates. Meanwhile, by focusing on financial activities, the federal government is pursuing a consumer protection framework less prone to arbitrage and a view of prudential risk suited to the fragmentation of fintech.

This Article is the first to identify the New Fintech Federalism, examining how its disparate set of legal experiments could revolutionize U.S. financial regulation. It also details a statutory intervention that would promote the interests of entrepreneurs and consumer protection advocates alike by codifying this emergent approach. Far from jettisoning federalism, this Article's proposed legislation would harness the distinctive strengths of

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the state and federal governments to bolster America's economic vitality and global competitiveness.

Introduction

The financial services industry has rapidly transformed over the past twenty years. From lending to payment processing, the core functions of banks are increasingly performed by financial technology (fintech) firms.[1]

Fintech companies use digital platforms and innovative data processing techniques, including automation and artificial intelligence,[2] to provide customers cheaper and more

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[1] *See* Rory Van Loo, *Making Innovation More Competitive: The Case of Fintech*, 65 UCLA L. REV. 232, 238 (2018); David Zaring, *Modernizing the Bank Charter*, 61 WM. & MARY L. REV. 1397, 1449 (2020).

[2] *See* Christopher G. Bradley, *Fintech's Double Edges*, 93 CHI.-KENT L. REV. 61, 77 (2018) (defining fintech as "any tool or application that relies

convenient financial products.[3] The onset of the COVID-19 pandemic and associated shelter-in-place orders further entrenched fintech's importance to the U.S. financial system, as many consumers flocked to digital providers.[4] Without the overhead of brick-and-mortar banks, fintech firms are remarkably lean, allowing them to pass savings onto customers. Indeed, many fintech firms are little more than startups.[5]

In contrast to traditional banks' generalist posture as one-stop shops, fintech firms typically specialize in a single kind of financial service.[6] This feature of fintech has produced two transformative impacts on the global financial system: (1) disaggregation, as the once-unified process of accepting deposits, extending credit, and processing payments has fragmented across various firms;[7] and (2) disintermediation, as these specialist firms have replaced traditional financial intermediaries like banks.[8]

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in any significant part on advanced technology to perform a role significantly related to financial transactions"); Chris Brummer & Yesha Yadav, *Fintech and the Innovation Trilemma*, 107 GEO. L.J. 237, 269 (2019) ("[A] signature feature of fintech lies in the increasing prevalence and centrality of automation and machine learning.").

[3] Charles W. Calomiris, *Chartering the Fintech Future*, 41 CATO J. 383, 390 (2021).

[4] For a recent analysis of the pandemic's impact on consumer finance in the United States, see Julie Andersen Hill, *COVID-19, Banks, and Fintechs*, 74 CONSUMER FIN. L.Q. REP. 346 (2021).

[5] *See* William Magnuson, *Regulating Fintech*, 71 VAND. L. REV. 1167, 1200 (2019) (observing "the typical fintech firm is small [and] leanly staffed").

[6] *See* Calomiris, *supra* note 3, at 387 ("[T]hese new competitors are structured very differently from traditional banks. They tend to focus on one or two lines of business, and typically provide either loan services or payments services, but not both."); Adam J. Levitin, *Rent-a-Bank: Bank Partnerships and the Evasion of Usury Laws*, 71 DUKE L.J. 329, 339 (2021) ("[A] new phenomenon has emerged in consumer lending: the different components of the lending cycle are split up and performed by multiple institutions, rather than by a single 'lender.'").

[7] Levitin, *supra* note 6, at 356; *see also* Calomiris, *supra* note 3, at 387-88 ("In theory, bundling of payments and lending generally is understood to reflect *informational* advantages from combining both within the same intermediary. . . . Such bundling advantages become less relevant as new screening and monitoring technologies provide alternative approaches to reducing information costs associated with lending.").

[8] Brummer & Yadav, *supra* note 2, at 242 ("Instead of established financial firms offering a one-stop shop for these services, fintech firms are dissecting and disintermediating their delivery, leading to the potential for

American law has struggled to accommodate the disaggregating and disintermediating nature of fintech.[9] Instead, the United States has labored under a division of regulatory authority between the state and federal governments designed to govern a financial landscape comprised of banks and large shadow banks.[10]

To catch up to the market, state and federal officials have undertaken a diverse array of regulatory initiatives. Yet the resulting legal frameworks have varied widely, yielding a jumble of policies with contradictory means and incoherent ends.[11] Commentators have characterized the inconsistencies among federal and state responses to fintech as a crisis for the federalist structure of U.S. financial regulation.[12]

Numerous officials have relied on the prevailing regulatory paradigm of the past century, seeking to extend its already stretched logic into the realm of fintech and exacerbating its many shortcomings in the process.[13] These traditional approaches insist that states must control fintech activities that

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fragmentation in the supply chain."); Howell E. Jackson, *The Nature of the Fintech Firm*, 61 WASH. U. J.L. & POL'Y 9, 12 (2020).

[9] Alan McQuinn & Daniel Castro, *The Case for a U.S. Digital Single Market and Why Federal Preemption Is Key*, INFO. TECH. & INNOV. FOUND. 9 (Oct. 2019) ("[W]hile the payment landscape has changed, the regulatory environment remains largely intact."), https://itif.org/publications/2019/10/07/case-us-digital-single-market-and-why-federal-preemption-key.

[10] *See* Magnuson, *supra* note 5, at 1169.

[11] *See* Sarah Jane Hughes, *Conceptualizing the Regulation of Virtual Currencies and Providers: Friction Points in State and Federal Approaches to Regulating Providers of Payments Execution and Custody Services and Products in the United States*, 62 CLEV. ST. L. REV. 43, 45 (2019) (noting these "competing regulatory priorities and approaches").

[12] *See, e.g.*, Christopher K. Odinet, *Predatory Fintech and the Politics of Banking*, 106 IOWA L. REV. 1739, 1741 (2021) ("While the United States is preoccupied with a pandemic and a mounting recession, a struggle of federalism in the banking sector is playing out in real time."); Hughes, *supra* note 11, at 45-48 (arguing "[w]e stand at a friction point in the regulation of [fintech]" due to "the rapidly multiplying approaches to these issues at the federal and state levels"); *see also* Edwin Adrian Bogert, Note, *Anti-Federalist Banking Policy Under Dodd-Frank: The Case for the Liberal Pre-Emption of State Banking Law*, 6 U. PA. J.L. & PUB. AFF'RS 309, 314 (2020) (decrying consumer financial protection reforms applicable to fintech firms as "departures from our Dual Banking system").

[13] *See infra* Part I.

occur within their borders[14] using the longstanding tools of compulsory licensing, bond-posting, and consumer protection.[15] But for online fintech firms, the costs of complying with a morass of duplicative or conflicting state laws is onerous and in some cases prohibitive.[16]

At the federal level, proponents of the prevailing paradigm have embraced entity-based regulation.[17] They have expanded preemption for federally chartered firms, immunizing them from state laws.[18] For fintech companies, federal preemption has served as a vehicle for regulatory arbitrage, encouraging rent-a-bank schemes that undermine consumer protection laws.[19] The federal entity-based view also permeates the binary approach to systemic risk controls that fixates on large systematically important financial institutions (SIFIs), while overlooking the growing macroprudential threat posed by a fragmented fintech sector.[20]

But several regulatory initiatives of the past decade have broken with prior thinking and charted a different path, one that redefines the relative realms of the federal and state governments and promises a legal regime suited to the technological realities of twenty-first century finance.[21] This emergent paradigm—the New Fintech Federalism—constitutes a radical reversal of the prior division of authority between state and federal actors. Through both cooperative and unilateral initiatives, the states are increasingly adopting an entity-based

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[14] *See* Benjamin Lo, *Fatal Fragments: The Effect of Money Transmission Regulation on Payments Innovation*, 18 YALE J.L. & TECH. 111, 119 (2016); Saule T. Omarova, *Dealing with Disruption: Emerging Approaches to Fintech Regulation*, 61 WASH. U. J.L. & POL'Y 25, 46 (2020).

[15] *See infra* Section I.A.

[16] *See* McQuinn & Castro, *supra* note 9, at 1 ("[T]here is a growing disjuncture between local governance and the national and international nature of the Internet."); *see also* Lo, *supra* note 14, at 119 ("Balkanized money transmitter regulations have thus become one of the main impediments to startup growth.").

[17] *See infra* Section I.B.

[18] Preemption has long been a bedrock of federal financial regulation. Henry N. Butler & Jonathan R. Macey, *The Myth of Competition in the Dual Banking System*, 73 CORNELL L. REV. 677, 678 (1988) ("Federal preemption and uniformity, rather than competition and diversity, are the legal norms in banking regulation.").

[19] *See infra* notes 137-147 and accompanying text.

[20] *See infra* Section I.B.2.

[21] *See infra* Part II.

approach rooted in interstate reciprocity that inures the benefits of jurisdictional competition and reduces the costs of redundant mandates.[22] Meanwhile, by focusing on financial activities, the federal government is pursuing a consumer protection framework less prone to arbitrage and a view of prudential risk suited to the fragmentation of fintech.[23]

The New Fintech Federalism is a sound governmental response to a matter of straightforward economic logic. Because fintech firms offer services online, their business model is inherently inter-jurisdictional.[24] Accordingly, subjecting fintech firms to the divergent legal regimes of each state in which they operate entails steep compliance costs that threaten the economic viability of startups and hinder American innovation.[25] Yet allowing fintech firms to opt into a single state's laws is similarly undesirable. In deciding where to incorporate, a fintech founder will seek to maximize the value of her firm by choosing the regime most beneficial to her investors,[26] who are typically sophisticated venture capital fund managers.[27]

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[22] *See infra* Section II.A.

[23] *See infra* Section II.B.

[24] Brian Knight, *Federalism and Federalization on the Fintech Frontier*, 20 VAND. J. ENTER. & TECH. L. 129, 135 (2017) ("[T]he Internet does not observe geographic boundaries or borders. As a result, assumptions about the geographic and political limits of a company's market that underpinned previous regulations may no longer hold." (internal quotation marks omitted)); Zaring, *supra* note 1, at 1449 ("As a matter of technology, these fintechs need not distinguish between any states in making business decisions—they exist on the Internet and can serve anyone with Internet access, and the Internet does not respect state boundaries.").

[25] Lo, *supra* note 14, at 118 ("State exemptions are highly variable, making it difficult for a startup to serve a nationwide market."); Ctr. for Cap. Markets Competitiveness, *Digital Assets: A Framework for Regulation to Maintain the United States' Status as an Innovation Leader*, U.S. CHAMBER COMM. 41 (Jan. 2021), https://www.uschamber.com/sites/default/files/ccmc_digitalassets2021_v3.pdf.

[26] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 312-13 (1976); *cf.* Butler & Macey, *supra* note 18, at 683 n.22 ("[F]or banking as for corporation law—the managers of the firm have an economic incentive to maximize the value of the firm and thus select the set of regulations that achieves that goal.").

[27] Jeff Galvin et al., *Synergy and Disruption: Ten Trends Shaping Fintech*, MCKINSEY & CO. 1 (Dec. 2018) ("[G]lobal venture capital (VC) fintech investment in 2018 has already reached $30.8 billion, up from $1.8 billion in 2011."), https://www.mckinsey.com/industries/financial-services/our-insights/synergy-and-disruption-ten-trends-shaping-fintech.

However, the founder lacks an incentive to fully internalize the costs of her choice of jurisdiction on remote third parties[28] or unsophisticated consumers unable to protect themselves via contract.[29] Instead, founders will systematically shift choice-of-jurisdiction costs onto those constituencies, generating externalities. To cater to founders, states competing for fintech charters will adopt under-protective rules, since they receive the entire benefit of chartering fees yet suffer only a fraction of the costs imposed on the national population.[30] This spillover effect is most pronounced in smaller, less populous states.

The optimal regulatory regime therefore federalizes legal issues in areas that generate significant externalities,[31] such as consumer protection[32] and prudential requirements,[33] while fostering state competition in areas like fintech governance that are unlikely to produce substantial spillovers.[34] The New Fintech Federalism follows precisely this path by reversing the

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[28] *See* Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1435, 1489 (1992).

[29] *See* Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 7 (2008); Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 633 (1943). *But see* Knight, *supra* note 24, at 196 (arguing "consumers are not powerless and can choose to avoid bad products."). But Knight's argument overlooks the fact that consumers are unlikely to expend the time and effort to accurately assess choice of law provisions in clickwrap contracts when choosing fintech products. *See* Bar-Gill & Warren, *supra*, at 12 ("[A]n imperfectly rational consumer might be aware that she is uninformed, yet mistakenly believe that the unknown information is trivial, irrelevant, or insufficiently important to justify the cost of its acquisition.").

[30] Lucian Bebchuk has developed this insight in the analogous context of corporate law. *See* Bebchuk, *supra* note 28, at 1441 ("[W]henever significant externalities are present, states will tend to provide corporate law rules that differ from the socially desirable ones in a direction that systematically disfavors such third parties.").

[31] *See id.* at 1485-86 ("If a rule is designed at the federal level, it is possible that officials shaping this rule will take into account the interests of parties other than shareholders."); Aziz Z. Huq, *Does the Logic of Collective Action Explain Federalism Doctrine?*, 66 STAN. L. REV. 217, 227 (2014) ("[A]llow federal regulation when Congress seeks to 'regulate problems or activities that produce spillover effects between states or generate collective action problems that concern more than one state.'" (quoting Jack M. Balkin, *Commerce*, 109 MICH. L. REV. 1, 6 (2010))).

[32] *See infra* notes 127-128 and accompanying text.

[33] *See infra* notes 356-357 and accompanying text.

[34] *See infra* notes 195 and accompanying text.

prevailing division of authority between state and federal regulators.

This Article is the first to identify the New Fintech Federalism, examining how its disparate set of legal experiments could revolutionize U.S. financial regulation. While previous commentators have discussed its constituent initiatives in isolation, they have failed to appreciate their collective significance for the federalist structure of American financial law—a reversal of the activity- and entity-based foundations of the prevailing state-federal paradigm. Beyond celebrating the New Fintech Federalism, this Article proposes a comprehensive legislative solution for Congress to realize its elegant marriage of jurisdictional competition and steadfast commitments to consumer protection and prudential safeguards.[35]

Part I of this Article analyzes the division of authority among state and federal regulators that has prevailed in the U.S. for over a century, with state restrictions on a broad range of financial activities and federal interventions in favor of banks and their affiliated entities. It discusses how extensions of this already infirm approach to fintech at the state and federal level have generated cumbersome compliance costs and abusive regulatory arbitrage. Part II surveys the legal reforms of the past decade that embody a new paradigm, defined by reciprocal state regulation of fintech entities and federal authority over externality-heavy financial activities. Because regulators remain committed to the status quo and many of these initiatives are nascent, Part III calls on Congress to enact legislation that codifies and builds upon the benefits of the New Fintech Federalism. It details a statutory intervention that would promote the interests of entrepreneurs and consumer protection advocates alike. Far from jettisoning federalism, this Article's proposed legislation would harness the distinctive strengths of the state and federal governments to bolster America's economic vitality and global competitiveness.

I. The Prevailing Paradigm and Its Flawed Extensions to Fintech

Fintech firms in the United States operate in a federalist legal regime that was not designed for them. Exercising an array of regulatory tools developed to handle the exigencies of local commerce, states require fintech companies to submit to a host of burdensome rules in exchange for the privilege of

[35] *See infra* Part III.

performing financial activities within their borders.[36] Compliance with the diverse licensing, oversight, consumer protection, and safety-and-soundness rules of each state in which a fintech operates is a costly proposition for online firms.[37] Moreover, the cumulative social benefits from each additional regime are minimal at best.[38] Yet states have not only maintained their financial activities laws, but also affirmatively extended them to fintech firms through new licensing regimes aimed at activities like cryptocurrency trading.[39] Unsurprisingly, these traditionalist initiatives have merely replicated the costs of prior state statutes, while paying little heed to regulatory spillovers.[40] As a result, the dominant, activities-based approach to fintech among state regulators has inflicted unnecessary costs on entrepreneurs and small state residents.

Similarly, the prevailing approach to federal financial regulation has poorly addressed the emerging challenges of fintech. Wielding the cudgel of preemption, federal regulators have long exempted entities with federal privileges—banks—from divergent state mandates.[41] But doing so has induced fintech firms to embrace expensive rent-a-bank schemes that satisfy the strictures of legal form yet empower fintech firms to evade state consumer protection and prudential laws in substance.[42] Likewise, the younger realm of federal systemic risk regulation is beset by a focus on entities that is ill suited to fintech. Because federal macroprudential statutes reflect a

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[36] *See* McQuinn & Castro, *supra* note 9, at 9 ("These laws and certifications conflict between different states, and businesses that try to break out in the payment space are saddled with getting complicated and expensive licenses for each state in which they operate.").

[37] *See id.*; Lo, *supra* note 14, at 119.

[38] *See* Knight, *supra* note 24, at 184-85 (describing the problem of redundant state statutes).

[39] *See, e.g.*, Michael J. Casey, *NY Financial Regulator Lawsky Releases Final BitLicense Rules for Bitcoin Firms*, WALL ST. J. (June 3, 2015) ("The first-of-their-kind rules will require certain providers of digital-currency services operating in New York State—in particular, those with custody of customers' funds and which exchange virtual currencies for dollars and other fiat currencies—to apply for a specially tailored Department of Financial Services license."), https://www.wsj.com/articles/ny-financial-regulator-lawsky-releases-final-bitlicense-rules-for-bitcoin-firms-1433345396.

[40] *See infra* notes 88-95, 102-103 and accompanying text.

[41] John P.C. Duncan, *The Course of Federal Pre-Emption of State Banking Law*, 18 ANN. REV. BANKING L. 221, 311-12 (1999).

[42] *See* HOWELL E. JACKSON & MARGARET E. TAHYAR, FINTECH LAW: THE CASE STUDIES 13 (2020); Levitin, *supra* note 6, at 359.

singular concern with SIFIs, officials tasked with policing systemic risk have struggled to account for the growing macroprudential threat posed by a fragmented fintech sector comprised of many small, interconnected firms.[43]

State and federal officials continue to recycle policy strategies that have proven inadequate to address the needs of today's markets. Widespread reliance on financial federalism's traditional division of authority has only multiplied the prevailing system's failures and obscured emergent problems.

A. State Regulation: Inefficient Inconsistencies

As non-banks engaged in financial services, fintech firms are subject to a patchwork of state laws from each jurisdiction in which they operate.[44] Even within a single state, fintech firms can fall under multiple regulatory regimes because different statutes apply to different activities, such as issuing loans or transmitting money.[45] State regulation of fintech overwhelmingly pertains to consumer protection and safety and soundness.[46] Although these goals are laudable, pursuing them on a state-by-state basis through duplicative mandates imposes prohibitive costs on fintech startups, reducing the dynamism of the U.S. financial sector.[47] Territorial fintech regulations also raise

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[43] Magnuson, *supra* note 5, at 1170; Jason Healey et al., *The Future of Financial Stability and Cyber Risk*, BROOKINGS INSTITUTION 13 (Oct. 2018), https://www.brookings.edu/wp-content/uploads/2018/10/Healey-et-al_Financial-Stability-and-Cyber-Risk.pdf.

[44] John L. Douglas, *New Wine into Old Bottles: Fintech Meets the Bank Regulatory World*, 20 N.C. BANKING INST. 17, 32 (2016); Lo, *supra* note 14, at 120.

[45] *See License to Bank: Examining the Legal Framework Governing Who Can Lend and Process Payment in the Fintech Age: Statement for the Record to the Task Force on Financial Technology of the U.S. House Comm. on Fin. Servs.*, 116th Cong. 3 (2020) (statement for the record of the Conference of State Bank Supervisors) [hereinafter *License to Bank*].

[46] Knight, *supra* note 24, at 155 ("[S]tate laws are more concerned with consumer protection and the safety and soundness of the service provider.")

[47] Nakita Q. Cuttino, *The Rise of "Fringetech": Regulatory Risks in Earned-Wage Access*, 115 NW. U. L. REV. 1505, 1563 (2021) ("FinTech firms . . . utilize technology to facilitate borderless transacting. Their profitability is often contingent on scaling, which a state-by-state regulatory regime greatly inhibits, if not prohibits altogether."); McQuinn & Castro, *supra* note 9, at 3.

legitimacy concerns by allowing larger states like New York to effectively dictate policy in smaller states.[48]

Under the traditional tenets of U.S. financial federalism, the states possess primary legal authority over non-banks.[49] Indeed, state law dominance over non-bank financial activities dates back to the eighteenth century.[50] Today, each state has enacted a different combination of laws regulating a variety of statutorily defined financial activities,[51] including: issuing loans (from consumer[52] and payday[53] loans to automobile debt[54] and mortgages[55]), servicing debts,[56] and transmitting money.[57]

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[48] *See* Van Loo, *supra* note 1, at 243-44 (describing how "some states—especially those with many traditional financial institutions, such as New York and Connecticut—erect licensing barriers targeted at blocking fintech startups").

[49] Lenore Palladino, *Small Business Fintech Lending: The Need for Comprehensive Regulation*, 24 FORDHAM J. CORP. & FIN. L. 77, 96 (2019) ("States are the primary regulators of nonbank financial entities."); *see also License to Bank*, *supra* note 45, at 2; Carl Felsenfeld, *Competing State and Federal Roles in Consumer Credit Law*, 45 N.Y.U. L. REV. 487, 489 (1970) ("[T]he impact of the Federal Government . . . has, however, been clearly secondary to the role of state law.").

[50] *See* Nicholas K. Tabor et al., *A Brief History of the U.S. Regulatory Perimeter* 5-6 (Fed. Res. Bd. of Govs., Fin. & Econ. Paper No. 051, 2021) (discussing how state restraining acts policed financial activities by non-banks), https://www.federalreserve.gov/econres/feds/files/2021051pap.pdf.

[51] *See* Hughes, *supra* note 11, at 52; McQuinn & Castro, *supra* note 9, at 9; Van Loo, *supra* note 1, at 238.

[52] *E.g.*, MONT. CODE § 32-5-101 (2021); *see also 50-State Survey of Consumer Finance Laws*, CONF. STATE BANK SUPERVISORS (Nov. 19, 2020), https://www.csbs.org/50-state-survey-consumer-finance-laws.

[53] *E.g.*, TENN. CODE ANN. § 45-17-101 (2021); *see also* Heather Morton, *Payday Lending State Statutes*, NAT'L CONF. STATE LEGISLATURES (Nov. 12, 2020), https://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx.

[54] *E.g.*, MO. REV. STAT. § 367.506 (2021).

[55] *E.g.*, 7 PA. CONS. STAT. § 6111 (2021).

[56] *E.g.*, FLA. STAT. § 559.553 (2021); *see also State Licensing: Debt Collector*, CORNERSTONE (2019) (surveying state debt collector statutes), https://cornerstonesupport.com/debt-collection-licensing-statutes/.

[57] *E.g.*, N.Y. BANKING LAW § 641 (2021); *see also* Thomas Brown, *50-State Survey: Money Transmitter Licensing Requirements*, PAUL HASTINGS LLP (2013), https://abnk.assembly.ca.gov/sites/abnk.assembly.ca.gov/files/50%20State%20Survey%20-%20MTL%20Licensing%20Requirements(72986803_4).pdf.

The heart of the state-by-state approach to regulating non-banks is licensing.[58] These statutes require non-banks to acquire a license from the state financial regulator before offering specified services within the state.[59] Because licensing statutes apply only to firms that perform specific financial functions, they embody an "'activities-based' as opposed to 'entity-based'" regime.[60]

Failure to procure an applicable license carries serious penalties, ranging from civil liability to criminal punishment.[61] But applying for a license is a costly and time-consumer endeavor.[62] A firm seeking a single state's license can expect to spend over $1 million and wait two years for a final decision.[63]

Once licensed, non-banks are subject to oversight by the state's financial regulator.[64] They must file annual financial reports, pay fees, and submit to regular examinations.[65] Even state regulators have described the examination process as "document-heavy and time-consuming" for firms.[66]

In addition to licensing requirements, state laws impose a variety of consumer protection obligations on non-banks. The

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[58] *See* Jeffrey Luther, Note, *Twenty-First Century Financial Regulation: P2P Lending, Fintech, and the Argument for a Special Purpose Fintech Charter Approach*, 168 U. PA. L. REV. 1013, 1034 (2020) ("The most routine interaction between state regulators and [fintech] lenders is through licensing.").
[59] Lo, *supra* note 14, at 119 ("If the startup is not a bank, it must embark upon the difficult path of navigating exemptions and registration requirements in each state it wishes to do business."); CONF. OF STATE BANK SUPERVISORS, REENGINEERING NONBANK SUPERVISION: OVERVIEW OF NONBANK SUPERVISION 9 (Aug. 2019) ("In most cases, absent this license, a nonbank cannot conduct any business activity with consumers."), https://www.csbs.org/sites/default/files/chapter_two_-_overview_of_state_nonbank_supervision_2.pdf.
[60] *License to Bank*, *supra* note 45, at 3.
[61] Hughes, *supra* note 11, at 53; CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 9 ("[A]ny such business will be in violation of state law and subject to further enforcement penalties including fines and possible criminal sentencing.").
[62] J. Parker Murphy, Note, *More Sense than Money: National Charter Option for FinTech Firms Is the Right Choice*, 18 N.C. J.L. & TECH. 359, 384 (2017).
[63] *See* McQuinn & Castro, *supra* note 9, at 9.
[64] Odinet, *supra* note 12, at 1770.
[65] Cuttino, *supra* note 47, at 1530.
[66] CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 33.

foremost of these protections are usury limits,[67] which cap the interest rates that lenders can charge.[68] Usury prohibitions are the oldest form of financial regulation[69] and have been governed by state law since the Revolution.[70]

Today, every state has a usury statute,[71] but they vary considerably in their terms.[72] These statutes typically stipulate different maximum interest rates for different kinds of loans and then provide a byzantine array of exemptions.[73] While businesses often lament the expenditures necessary to determine the applicable interest rate ceilings for their loans, many usury statutes' labyrinthine exemptions are the product of non-banks' lobbying to ease usury restrictions.[74] As with licensing, the stakes of compliance are high, since usury violations result in civil and criminal liability.[75]

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[67] Felsenfeld, *supra* note 49, at 488 ("The fundamental laws controlling the extension of credit are, of course, the usury laws which exist in some form in every state.").

[68] Edward L. Glaeser & José Scheinkman, *Neither a Borrower nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws*, 41 J.L. & ECON. 1, 1 (1998).

[69] *Id.* (describing religious injunctions against usury in the Torah and Vedic scriptures). Debates surrounding the merits of usury prohibitions are just as old and continue to this day. *See* Mehrsa Baradaran, *Credit, Morality, and the Small-Dollar Loan*, 55 HARV. C.R.-C.L. L. REV. 63, 67 (2020). An important modern defense of usury justifies interest rate caps as preventing individuals from assuming too much debt and thereby externalizing their risk of default on the social safety net. *See* Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 302 (1995).

[70] *See* Levitin, *supra* note 6, at 347.

[71] Douglas, *supra* note 44, at 31.

[72] Michael Marvin, Note, *Interest Exportation and Preemption:* Madden*'s Impact on National Banks, the Secondary Credit Market, and P2P Lending*, 116 COLUM. L. REV. 1807, 1813 (2016) ("[T]here is wide variation across states in what constitutes usurious interest on consumer credit: Whereas in Utah there is no interest rate cap on consumer loans in writing, in Alabama interest rates above 8% are usurious.").

[73] Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1116 (2008).

[74] *See id.*

[75] *See* Robert Mayer, *Loan Sharks, Interest-Rate Caps, and Deregulation*, 68 WASH. & LEE L. REV. 807, 830 (2012) (discussing "criminal penalties imposed for usurious lending").

Beyond usury limits, state consumer protection statutes often contain mandatory disclosures.[76] Although not as complex as usury statutes, disclosure obligations can be highly specific, requiring lenders to adopt certain layouts in their forms and present them to customers at stipulated points in the lending process.[77]

Finally, states regulate the safety-and-soundness of licensed non-banks.[78] Most significantly, firms must post surety bonds with the regulator of each state in which they operate.[79] When firms operate in multiple states, duplicative surety bond laws pose a major expense. For example, a non-bank hoping to serve customers in California, Texas, Florida, New York, and Illinois must post over $1 million in bonds.[80] States also require non-banks to satisfy a series of other safety-and-soundness obligations, including minimum net worth and liquidity requirements.[81] Notably, these safety-and-soundness laws are *microprudential* since they seek to avoid failure at the firm level, as opposed to *macroprudential* interventions that focus on the stability of the economy as a whole.[82]

Fintech firms are subject to the many burdens of the states' traditional, activities-based regime. Most often, fintech firms fall within the ambit of older statutes. For example, peer-to-peer fintech platforms, which match investors and borrowers, qualify as money lenders under many state laws.[83] So do earned wage fintech firms,[84] which offer advances on earned but

[76] CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 28.
[77] *Id.*
[78] Odinet, *supra* note 12, at 1770.
[79] Cuttino, *supra* note 47, at 1530.
[80] Lo, *supra* note 14, at 132.
[81] CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 28.
[82] *See, e.g.*, Katrien Morbee, *The Role of Corporate Governance in a Macroprudential Framework*, U. CHI. L. REV. ONLINE (Jan. 7, 2020) (distinguishing between micro- and macroprudential supervision), https://lawreviewblog.uchicago.edu/2020/01/07/the-role-of-corporate-governance-in-a-macroprudential-framework-by-katrien-morbee/.
[83] *See* Julia D. Corelli et al., *Top 5 Things You Should Know About Online Direct (P2P) Lending Law and Regulations*, MONDAQ (Apr. 30, 2014), https://www.mondaq.com/unitedstates/financial-services/310390/top-5-things-you-should-know-about-online-direct-p2p-lending-law-and-regulations-before-you-do-anything-else.
[84] *See* Cuttino, *supra* note 47, at 1530.

unpaid portions of employees' salaries.[85] Many more fintech firms constitute money transmitters, since these expansive statutes apply to "practically any business moving money on behalf of customers."[86] Fintech firms therefore must secure the relevant licensure, comply with consumer protection laws such as usury statutes, and satisfy the safety-and-soundness rules of each state in which they operate.[87]

In an attempt to modernize, several states have expressly extended traditional state law rules to fintech firms.[88] The most prominent attempt to repurpose the longstanding levers of state non-bank financial regulation for fintech companies is New York's BitLicense program.[89] In 2015, the New York State Department of Financial Services (NYDFS) promulgated a regulation providing: "No Person shall, without a license obtained from the superintendent . . . engage in any Virtual Currency Business Activity."[90] Accordingly, any fintech firm that receives, stores, or trades cryptocurrencies and does business in New York must comply with the BitLicense regime.[91] Despite the initiative's sleek branding, the substantive requirements of the BitLicense program are instantly recognizable as a continuation of the traditional activities-based approach: BitLicensees must undergo regular examinations by the NYDFS,[92] provide specified consumer protection disclosures,[93] post surety bonds,[94] and meet minimum capital levels.[95]

The activities-based framework that dominates state regulation of non-banks is no longer viable in the fintech era. Even

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[85] *Id.* at 1508.
[86] Lo, *supra* note 14, at 132; Robert P. Zinn et al., *U.S. Fintech Overview*, K&L GATES 8 (2019), https://files.klgates.com/webfiles/chambers_fintech_overview.pdf.
[87] Odinet, *supra* note 12, at 1778-79; CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 24.
[88] *See* Hughes, *supra* note 11, at 53 (discussing legislative amendments in North Carolina and Washington expressly applying their money transmitter statutes to cryptocurrency fintech firms).
[89] *See* Douglas, *supra* note 44, at 47 (explaining how the BitLicense law uses the same consumer protection framework as older money transmitter laws); Knight, *supra* note 24, at 167 (same).
[90] N.Y. COMP. CODES R. & REGS. tit. 23, § 200.3(a) (2021).
[91] *See id.* § 200.2(q) (defining "Virtual Currency Business Activity").
[92] *Id.* § 200.13.
[93] *Id.* § 200.19.
[94] *Id.* § 200.9.
[95] *Id.* § 200.8.

in isolation, each state's statutes inflict significant compliance costs on fintech firms—requiring them to determine which of the overlapping licensing laws they fall under, parse exemption-riddled consumer protection codes, and expend scarce capital on surety bonds.[96] Because fintech firms operate online and therefore are inherently cross-jurisdictional, these already severe compliance costs are multiplied many times over, as each jurisdiction's rules are idiosyncratic.[97] While large, incumbent firms might possess the resources to satisfy the diverging mandates of state financial regulators, fintech startups are poorly positioned to shoulder this burden given their limited capital.[98] These state laws harm not only fintech firms but also consumers, who are deprived of the benefits of vigorous competition in the financial sector,[99] and the United States a whole, which suffers from a less innovative and globally competitive economy.[100]

Regulating fintech firms on a state-by-state basis is a socially inefficient method of attaining consumer protection and safety-and-soundness. Even assuming each state's rules are optimal in isolation, the myriad variations among different jurisdictions' rules introduce costly redundancies with little marginal benefit to consumers.[101]

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[96] *Cf.* Lo, *supra* note 14, at 119 (noting "the difficult path of navigating exemptions and registration requirements").

[97] Alan McQuinn, *Supporting Financial Innovation Through Flexible Regulation*, INFO. TECH. & INNOVATION FOUND. 9 (Nov. 2019) ("Differing state licensing regimes increase costs significantly."), https://itif.org/sites/default/files/2019-fintech-regulations.pdf.

[98] *See* Knight, *supra* note 24, at 186 ("Having to research and comply with multiple regulations or having to pay for multiple licenses is inefficient, time consuming, and costly for companies, especially new firms with limited resources."); Lo, *supra* note 14, at 131 ("The requirement of individual state licensure can kill a startup early in its life . . . .").

[99] Knight, *supra* note 24, at 186; Lo, *supra* note 14, at 131.

[100] Ctr. for Cap. Markets Competitiveness, *supra* note 25, at 41 (observing that state regulation of fintech "hinder[s] technological progress in the U.S.A.").

[101] *See* CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 24 ("When two states have substantively similar requirements that are implemented differently, it is only natural to find the differences akin to busy work and not policy objectives. This is felt in financial services when businesses seek to operate across state lines, only to find a series of similar requirements that offer no greater consumer protection or market access, and this can result in claims that the patchwork quilt is burdensome and restrictive."); *see also* Lo, *supra* note 14, at 131 ("[M]ultiple overlapping and conflicting

The prevailing approach to fintech regulation among the states also raises political legitimacy concerns. When large states regulate fintech products, those rules become de facto requirements in other states as well, since fintech firms are loath to cease operating in a major market like New York. In the horizontal federalism literature, this effect is known as a regulatory spillover.[102] Meanwhile, fintech firms will more readily abandon small states that attempt similar regulatory reforms.[103] Residents of smaller states therefore have the unfortunate choice of either following in the wake of larger states or forgoing the benefits of fintech altogether, leaving them without meaningful voice in the national debate over how to regulate fintech.

Thus, extensions of the pervasive activities-based approach to fintech firms have proven undesirable. Although the various aims of state statutes—such as oversight, consumer protection, and safety and soundness—are worthwhile, the territorial application of divergent state laws has produced onerous compliance costs and political dysfunction.

B. Federal Regulation

The federal approach to financial regulation has long been rooted in entity-based designations. But increasingly, the rigidity of this framework has proven a liability in confronting the needs of a disaggregated and disintermediated financial sector.

To create a national market that avoids the morass of activities-based state laws, federal officials have embraced an aggressive preemption strategy in favor of chartered banks.[104] Most importantly, federal law allows banks to "export" the usury rates of their home state to any jurisdiction in the country, effectively immunizing them from state usury statutes.[105] Eager to exploit the advantages of interest rate exportation

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licensing requirements are unlikely to add much to overall consumer protection.").

[102] *See* Heather K. Gerken & Ari Holtzblatt, *The Political Safeguards of Horizontal Federalism*, 113 MICH. L. REV. 57, 71 (2014) ("[S]pillovers allow states to export some of the costs associated with their regulations, which leads states to interfere more with free trade than they would if they fully internalized the cost of that decision.").

[103] *See* Murphy, *supra* note 62, at 388; Knight, *supra* note 24, at 195.

[104] Butler & Macey, *supra* note 18, at 678.

[105] *See* Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 312-13 (1978).

without the burdens of bank regulations, fintech firms have instead developed elaborate "rent-a-bank" schemes to offer services around the country yet attribute these services to a partnering bank.[106] As a result, federal regulators' entity-based preemption strategy has yielded elaborate evasion and pernicious arbitrage.

Federal law has similarly suffered from an entity-based approach in the newer realm of systemic risk regulation. Developed in the wake of the 2008 financial crisis, the U.S. macroprudential risk framework remains fixated on the dangers of large, interconnected non-banks, known as SIFIs.[107] Yet the advent of fintech has introduced a diametrically different threat to the stability of the U.S. economy: as traditional banking functions disperse across small firms with fewer institutional resources and reputational commitments, excessive risk-taking by a single firm could trigger cascading failures down the supply chain.[108] Fintech's systemic risk implications have therefore confounded existing federal law.

1. Preemption and Its Abuses

Attempts to regulate fintech at the federal level have largely pursued a threadbare strategy of ever-greater preemption.[109] Due to the Supremacy Clause,[110] federal law displaces contrary state law commands.[111] There are three primary forms of preemption: express preemption, when federal law explicitly displaces a category of state law; conflict preemption, when state law would impermissibly impede the accomplishment of

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[106] Odinet, *supra* note 12, at 1769; *see also* Levitin, *supra* note 6, at 387 (examining one such fintech-bank partnership).
[107] *See* Aaron M. Levine & Joshua C. Macey, Note, *Dodd-Frank Is a Pigouvian Regulation*, 127 YALE L.J. 1336, 1339 (2018).
[108] *See infra* notes 214-220 and accompanying text.
[109] *See* J.W. Verret, *A Dual Non-Banking System? Or a Non-Dual Non-Banking System? Considering the OCC's Proposal for a Non-Bank Limited Charter for Fintech Firms, Against and Alternative Competitive Federalism System, for an Era of Fintech Banking* 31-32 (Geo. Mason L. & Econ. Res. Paper No. 17-05, 2017) (discussing federal initiatives "to preempt duplicative state licensing regimes").
[110] U.S. CONST. art. VI, para. 2 ("This Constitution, and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land.").
[111] *See* Jay B. Sykes, Cong. Research Serv., R45081, *Banking Law: An Overview of Federal Preemption in the Dual Banking System* 2-3 (2018).

a federal statutory objective; and field preemption, when federal intervention in a field is so pervasive as to vitiate any state law on the subject.[112]

Entity-based preemption has served as the dominant tool in federal financial regulation since the creation of the Bank of the United States and seminal case of *McCulloch v. Maryland*.[113] This strategy continued with the adoption of the National Bank Act of 1864 (NBA),[114] which created the Office of the Comptroller of the Currency (OCC) and authorized it to charter national banks.[115] Indeed, the NBA was primarily a business organization statute,[116] governing national banks' formation, corporate powers, directorships, shareholder votes, dividends, and liquidation procedures.[117] But unlike federal regulation of externality-intensive matters, the NBA's entity-based preemption of governance rules stifles the salutary effects of jurisdictional competition that are well-appreciated in corporate law scholarship.[118] Indeed, because many of the

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[112] *Id.* at 3-4.

[113] 17 U.S. (4 Wheat.) 316, 400 (1819) ("[T]he law of Congress establishing the bank . . . must have its full and complete effects. Its operation cannot be either defeated or impeded by acts of State legislation."); *see* Roderick M. Hills, Jr., *Exorcising* McCulloch*: The Conflict-Ridden History of American Banking Nationalism and Dodd-Frank Preemption*, 161 U. PA. L. REV. 1236, 1237 (2013) ("Since the Supreme Court handed down *McCulloch v. Maryland*, judges and scholars have commonly declared that 'history' has called for centralized law governing nationally chartered banks.").

[114] Ch. 106, 13 Stat. 99 (codified as amended at 12 U.S.C. § 21 et seq. (2018)).

[115] *See* Bogert, *supra* note 12, at 315-16; Butler & Macey, *supra* note 18, at 681; Alejandro Komai & Gary Richardson, *A Brief History of Regulations Regarding Financial Markets in the United States 1789 to 2009*, at 4 (Nat'l Bur. Econ. Res. Working Paper No. 17443, 2011), https://www.nber.org/papers/w17443.

[116] Lev Menand & Morgan Ricks, *Federal Corporate Law and the Business of Banking*, 88 U. CHI. L. REV. (forthcoming 2022) (manuscript at 14) ("[T]he original Act was largely devoted to enacting corporate law.").

[117] *Id.* at 14-15.

[118] Butler & Macey, *supra* note 18, at 693 ("[F]orces work to prevent the realization of true regulatory competition in the market for bank charters. The first is the ability of the federal government, through the supremacy clause, to trump state regulation when doing so serves its interests."); *cf.* Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 U. CHI. L. REV. 1484, 1498 (1987) ("A consolidated national government has all the drawbacks of a monopoly: it stifles choice and lacks the goad of competition."). For a canonical argument in favor of jurisdictional competition in corporate law, see Ralph K. Winter, Jr., *State Law, Shareholder Protection and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977).

NBA's original governance provisions remain binding today, "compared to modern corporation law statutes, the NBA is quite primitive."[119]

The Supreme Court repeatedly endorsed the federal entity-based preemption strategy when banks sought to avoid state consumer protection and usury laws.[120] In the landmark decision of *Marquette*,[121] the Court interpreted the NBA's provision allowing national banks to charge customers around the United States the maximum rates permitted where the bank is "located."[122] The Justices unanimously concluded that the jurisdiction designated in the bank's charter determined the bank's location for purposes of the NBA.[123]

Because restrictions on interstate banking were widespread at the time, *Marquette*'s effect remained muted until Congress passed the Riegle-Neal Act of 1994,[124] which allowed banks to open branches across state lines.[125] Since Riegle-Neal, banks can designate any state in which they have a branch as their "location" under the NBA and then export that state's interest rate caps nationwide.[126] State legislatures in search of greater fees capitalized on Riegle-Neal by participating in a usury law "race to the bottom."[127] Banks relocated en masse to jurisdictions with minimal usury restrictions, like South Dakota and Delaware.[128]

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[119] Menand & Ricks, *supra* note 116, at 16.

[120] *See* CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 21 ("State regulators have witnessed . . . the preemption of anti-predatory lending laws, adjustable rate mortgage restrictions, and state oversight of national bank operating subsidiaries.").

[121] Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299 (1978) (Brennan, J.).

[122] 12 U.S.C. § 85 (2018).

[123] 429 U.S. at 312-13.

[124] Pub. L. No. 103-328, 108 Stat. 2338 (1994) (codified at 12 U.S.C. § 1811 (2018)).

[125] *See* Marvin, *supra* note 72, at 1819.

[126] *See id.* at 1820.

[127] Levitin, *supra* note 6, at 349; *see* Bar-Gill & Warren, *supra* note 29, at 83 ("By permitting the states to compete for business by offering less and less consumer protection, the regulation scheme starts to unravel.").

[128] Abbye Atkinson, *Rethinking Credit as Social Provision*, 71 STAN. L. REV. 1093, 1114 (2019) ("[M]any major banks moved their headquarters to states like South Dakota in order to take advantage of favorable state usury laws."); Levitin, *supra* note 6, at 340.

Marquette's entity-based preemption strategy eventually seeped beyond national banks. Congress subsequently allowed state-chartered banks with federal deposit insurance to export interest rate caps nationwide.[129] When the OCC took the more radical step of extending the full panoply of national banks' preemption benefits to their operating subsidiaries, the Supreme Court stressed the benefits of a national market[130] and upheld the OCC's decision.[131]

Federal officials' attempts to forge a national market through entity-based preemption has enabled banks to circumvent state consumer protection laws.[132] With an exportation doctrine bearing the imprimatur of the Supreme Court, banks regularly charge individuals interest rates far exceeding debtors' home state usury caps.[133]

Emboldened federal regulators sought to expand preemption further still. In 2004, the OCC adopted regulations for national banks, codifying a sweeping conception of conflict preemption that upended numerous state consumer protection statutes beyond usury caps.[134] But the entity-based logic of the federal paradigm reached its apex in a set of regulations by the Office of Thrift Supervision (OTS) declaring that *field preemption* applied to federal savings associations and their subsidiaries, such that states could no longer regulate their lending activities.[135]

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[129] Jayne Munger, Note, *Crossing State Lines: The Trojan Horse Invasion of Rent-a-Bank and Rent-a-Tribe Schemes in Modern Usury Law*, 87 GEO. WASH. L. REV. 468, 476 (2019).
[130] Watters v. Wachovia Bank, N.A., 550 U.S. 1, 11 (2007) (Ginsburg, J.) ("In the years since the NBA's enactment, we have repeatedly made clear that federal control shields national banking from unduly burdensome and duplicative state regulation.").
[131] *Id.* at 19.
[132] Atkinson, *supra* note 128, at 1113 ("The Court's decision [in *Marquette*] functionally deregulated interest rates across the country . . . ."); Bar-Gill & Warren, *supra* note 29, at 81 ("As a result, state interest rate regulation has been effectively preempted.").
[133] *See* James J. White, *The Usury Trompe L'Oeil*, 51 S.C. L. REV. 445, 445 (2000).
[134] *See* Jared Elosta, *Dynamic Federalism and Consumer Financial Protection: How the Dodd-Frank Act Changes the Preemption Debate*, 89 N.C. L. REV. 1273 (2011) (arguing the 2004 regulations are more accurately characterized as field preemption); Hills, *supra* note 113, at 1275.
[135] *See* Mark Totten, *Credit Reform and the States: The Vital Role of Attorneys General After Dodd-Frank*, 99 IOWA L. REV. 115, 124 (2013).

As federal preemption shielded banks from an ever-expanding set of state laws, non-banks found themselves at a competitive disadvantage. Most importantly, non-bank lenders still must comply with each state's usury laws, since they cannot invoke the exportation doctrine the *Marquette* Court read into the NBA.[136] Payday lenders were the first to discover that by partnering with banks, they could charge customers otherwise-usurious rates.[137] In these "rent-a-bank" arrangements, the non-bank solicits and underwrites loans but has a partner bank originate them, before immediately selling the loan back to the non-bank, which typically securitizes them for trading on secondary credit markets.[138] Because the bank does not retain the risk on the loans, its participation in the transaction is nominal.[139] As a matter of economic substance, the non-bank serves as the lender.[140] But the bank's formal role in originating the loans allows the non-bank to invoke the exportation doctrine and charge interest rates in excess of state usury limits.[141]

A similar arbitrage scheme exploits tribal sovereignty to evade state consumer protection laws. These arrangements are identical to "rent-a-bank" partnerships, except the non-bank has a tribal government originate the high-interest loan.[142] Since tribal governments are immune from state regulation, even when performing off-reservation commercial activities,[143] the non-banks can similarly evade state usury laws.[144]

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[136] Levitin, *supra* note 6, at 351-52 ("[S]tate usury laws were effectively gutted *for banks*. Notably, the erosion of state usury laws in the wake of *Marquette* did not extend to *nonbanks*.").
[137] Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 151-52 (2004); Munger, *supra* note 129, at 495.
[138] Odinet, *supra* note 12, at 1759; *see also* Jackson, *supra* note 8, at 13 (analogizing these arrangements to the Coasean firm's build-or-buy decision).
[139] Barr, *supra* note 137, at 151 (describing how "the bank retain[s] little or no risk").
[140] Levitin, *supra* note 6, at 360 ("[T]he key features are the bank taking its underwriting marching orders from the nonbank and the nonbank acquiring the lion's share of financial exposure on the loans.").
[141] Douglas, *supra* note 44, at 31; Verret, *supra* note 109, at 6.
[142] Baradaran, *supra* note 69, at 100; Munger, *supra* note 129, at 478.
[143] Michigan v. Bay Mills Indian Cmty., 572 U.S. 782, 785 (2014) (5-4) (Kagan, J.) ("Indian tribes have immunity even when a suit arises from off-reservation commercial activity.").
[144] Jenadee Nanini, *Tribal Sovereignty and FinTech Regulations: The Future of Co-Regulating in Indian Country*, 1 GEO. L. TECH. REV. 503, 504-05 (2017).

Although usury-rate evasion schemes originated with traditional non-bank lenders, many fintech firms have embraced these partnerships in recent years.[145] Exploiting the entity-based nature of federal financial regulation, fintech lenders have successfully engaged in regulatory arbitrage, subverting state consumer protection laws.[146] For example, using a "rent-a-bank" arrangement, one fintech firm charged customers interest rates as high as 365%.[147]

But the viability of partnering with banks and tribes to originate high-interest loans is increasingly uncertain, as courts have challenged its common law foundation: the valid-when-made doctrine.[148] Rooted in contractual assignment principles, under which "an assignee stands in the shoes of the assignor,"[149] the valid-when-made doctrine provides that if a loan is not usurious when originated, then it remains non-usurious when sold to another party.[150] Although the doctrine's historical pedigree is questionable,[151] fintech lenders and secondary credit markets have come to rely on the continued validity of high-interest loans originated by banks and then sold to non-banks.[152]

The Second Circuit issued a doctrinal challenge to the valid-when-made doctrine in the controversial decision of *Madden v. Midland Funding, LLC*.[153] Plaintiffs in the case argued that although Bank of America was entitled to charge otherwise-usurious interest rates on certain credit card loans,

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[145] *See, e.g.*, Jackson, *supra* note 8, at 13 (noting fintech rent-a-bank arrangements); Nanini, *supra* note 144, at 503 (discussing fintech partnerships with tribes).
[146] *See* Levitin, *supra* note 6, at 338 (arguing "the rent-a-bank issue is a function of . . . the entity-based nature of the system, which has left it vulnerable to regulatory arbitrage").
[147] Odinet, *supra* note 12, at 1763.
[148] Charles M. Horn & Melissa R.H. Hall, *The Curious Case of* Madden v. Midland Funding *and the Survival of the Valid-When-Made Doctrine*, 21 N.C. BANKING INST. 1, 6 (2017); Christopher K. Odinet, *Securitizing Digital Debts*, 52 ARIZ. ST. L.J. 477, 532 (2020) ("[T]his doctrine is vitally important to the fintech lending business model . . . .").
[149] Barbosa v. Midland Credit Mgmt., 981 F.3d 82, 90 (1st Cir. 2020).
[150] *See* Knight, *supra* note 24, at 145; Munger, *supra* note 129, at 488.
[151] *Compare* Horn & Hall, *supra* note 148, at 7, *with* Adam J. Levitin, *Spurious Pedigree of the "Valid-When-Made" Doctrine*, 71 DUKE L.J. ONLINE 87 (2022).
[152] Marvin, *supra* note 72, at 1837-38 (exploring secondary credit markets' reliance), 1841-42 (examining fintech firms' reliance).
[153] 786 F.3d 246 (2d Cir. 2015).

the subsequent sale of those loans to non-banks rendered the NBA inapplicable and the interest rates unlawful under New York usury law.[154] Reversing the district court, the Second Circuit held that the non-banks were not entitled to charge the interest rates exported by Bank of America, because the non-banks were not acting "on behalf of" the bank.[155] The Second Circuit's decision opened up a circuit split and roiled the financial services sector.[156]

The *Madden* rule, requiring *some* continued bank participation in loans to ensure exportation applies, has proven easy to evade.[157] The fintech lender Elevate simply altered its partnership agreements to require that the originating banks retain a small, fractional interest in the loans.[158] Instead of buying loans from originating banks outright, the fintech firm LendingClub now keeps the loans on the banks' balance sheets and provides regular payments to the banks in exchange for the loans' income streams.[159] Thus, far from solving the rent-a-bank problem inherent in the prevailing entity-based approach, *Madden* merely exacerbated transactions costs,[160] with little substantive change to show for these arbitrage scheme's newly baroque form.

A second alternative to the valid-when-made rule is the true lender doctrine.[161] This approach amounts to a "facts and circumstances" assessment of which party bears the economic

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[154] *Id.* at 247-48.
[155] *Id.* at 251-52 ("Although national banks' agents and subsidiaries exercise national banks' powers and receive protection under the NBA when doing so, extending those protections to third parties would create an end-run around usury laws for non-national bank entities that are not acting on behalf of a national bank.").
[156] Kirby M. Smith, Comment, *Banking on Preemption: Allowing National Bank Act Preemption for Third-Party Sales*, 83 U. CHI. L. REV. 1631, 1647 (2016) (citing the contrary decisions of *Krispin v. The May Department Stores Co.*, 218 F3d 919 (8th Cir 2000) and *FDIC v. Lattimore Land Corp.*, 656 F2d 139 (5th Cir 1981)); *see also* Horn & Hall, *supra* note 148, at 22 (describing the financial sector's reaction to *Madden*).
[157] Smith, *supra* note 156, at 1677.
[158] *See* Knight, *supra* note 24, at 146; Odinet, *supra* note 12, at 1793.
[159] *See* Marvin, *supra* note 72, at 1846.
[160] *Id.* at 1814 (discussing the "new transaction costs imposed by *Madden*"); Smith, *supra* note 156, at 1680.
[161] Robert Savoie & Philip Hoffman, *Marketplace Lending and Fintech: The States Object*, 73 BUS. LAW. 509, 514 (2018).

indicia of a lender in a given arrangement.[162] Several state legislatures enacted true lender statutes in response to rent-a-bank schemes,[163] while in other states the courts have adopted it as a matter of common law.[164] Recently, the District of Columbia Attorney General invoked the true lender doctrine in a usury suit challenging Elevate's bank partnerships.[165] But the true lender doctrine, like other facts and circumstances tests, introduces too much uncertainty into financial transactions, since outcomes are difficult to predict ex ante and depend on inexpert judicial second-guessing.[166] Moreover, the doctrine's antiquated conception of a single true lender is a poor fit for contemporary consumer credit transactions, in which one party solicits and underwrites a loan, another party originates it, and then the income streams are securitized and dispersed across secondary credit markets.[167]

In response to the rise of the *Madden* and true lender doctrines, federal regulators resorted to the familiar strategy of greater preemption. The OCC and Federal Deposit Insurance Corporation (FDIC) both enacted "*Madden* fix" rules rejecting the Second Circuit's interpretation of the NBA and codifying

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[162] Horn & Hall, *supra* note 148, at 12.

[163] *See* Levitin, *supra* note 6, at 396 n.297 ("The anti-evasion principle was codified in the 2004 Georgia Payday Lending Act, which responded to rent-a-bank payday lending. The Georgia Payday Lending Act included a provision that prohibited '[a]ny arrangement by which a de facto lender purports to act as the agent for an exempt entity.'" (citation omitted)).

[164] Odinet, *supra* note 12, at 1794 ("Since [the Georgia Payday Lending Act's] passage, courts in states such as New York, Maryland, and West Virginia have adopted the concept in dealing with similar situations.").

[165] *See* Ashley Simonsen et al., *Recent Developments in Valid-When-Made and True Lender Litigation*, 76 BUS. LAW. 645, 653 (2021); Michael Calhoun, *Bank Regulator's True Lender Rule Undercuts Bank Regulatory Protections and Shelters Predatory Lending*, BROOKINGS INSTITUTION (June 21, 2021), https://www.brookings.edu/blog/up-front/2021/06/21/bank-regulators-true-lender-rule-undercuts-bank-regulatory-protections-and-shelters-predatory-lending/.

[166] *Cf.* John Hannon, Note, *The True Lender Doctrine: Function over Form as a Reasonable Constraint on the Exportation of Interest Rates*, 67 DUKE L.J. 1261, 1291 (2018) (analyzing uncertainty from the true lender doctrine).

[167] *See* Levitin, *supra* note 6, at 413-14 ("[D]isaggregated lending can make it difficult to identify a single party that is the true lender. Although there are multiple parties that might contend for that role, the traditional framing of true lender doctrine conceives there as being a single true lender.").

the valid-when-made doctrine.[168] Additionally, the OCC adopted a rule providing that whenever a bank originates a loan, it is conclusively the true lender.[169] Yet these attempts to settle the valid-when-made debate were short lived. With the Biden administration's backing,[170] Congress took the extraordinary measure of voiding the OCC's true lender rule under the Congressional Review Act.[171] Meanwhile, several state attorneys general filed an ongoing lawsuit to invalidate the *Madden* fix rules under the Administrative Procedure Act.[172]

The advent of fintech has therefore revealed the shortcomings of the longstanding entity-based approach to federal financial regulation. By partnering with banks, fintech firms have evaded state usury laws and other consumer financial protections. While these arbitrage schemes represent an economically unsurprising attempt to avoid the onerous costs of complying with conflicting state-by-state rules, fintech firms' abuses of preemption have vitiated state rules but left nothing

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[168] Permissible Interest on Loans that Are Sold, Assigned, or Otherwise Transferred, 85 Fed. Reg. 33530 (June 2, 2020) (OCC); Federal Interest Rate Authority, 85 Fed. Reg. 44146 (July 22, 2020) (FDIC).

[169] National Banks and Federal Savings Associations as Lenders, 85 Fed. Reg. 68742 (Oct. 30, 2020).

[170] *Statement of Administration Policy: S.J. Res. 15*, OFF. MGMT. & BUDGET (May 11, 2021) ("The [true lender] rule . . . undermines state consumer protection laws and would allow the proliferation of predatory lending by unregulated payday lenders using, among other vehicles, 'rent-a-bank' schemes to funnel high-interest, predatory loans through national banks to evade state interest rate caps."), https://www.whitehouse.gov/wp-content/uploads/2021/05/SAP-S.J.-Res-15.pdf.

[171] *The OCC's True Lender Rule Has Been Repealed*, DAVIS POLK (July 1, 2021), https://www.davispolk.com/insights/client-update/occs-true-lender-rule-has-been-repealed.

[172] *See* Ronald K. Vaske, *State AGs File Opposition to FDIC's Summary Judgment Motion in Lawsuit Challenging* "Madden-*Fix" Rule*, BALLARD SPAHR: CONSUMER FIN. MONITOR (June 23, 2021), https://www.consumerfinancemonitor.com/2021/06/23/state-ags-file-opposition-to-fdics-summary-judgment-motion-in-lawsuit-challenging-madden-fix-rule/. While the district court recently ruled against the state attorneys general, they still may appeal that decision to the Ninth Circuit. *See* David I. Monteiro et al., "Madden *Fix" Rule Withstands a Key Test: What Happens Next*, MORGAN LEWIS (Feb. 10, 2022), https://www.morganlewis.com/blogs/finreg/2022/02/madden-fix-rules-withstand-a-key-test-what-happens-next.

in their place, resulting in a regulatory vacuum.[173] Moreover, banks' participation in abusive fintech partnerships amounts to rent-seeking from the sale of their federal regulatory subsidies.[174] That fintech firms pay banks for these benefits reveals how the dominant federal approach protects incumbent banks and places fintech startups at a competitive disadvantage.[175] Although preferential treatment for banks can be justified by the corresponding burdens of bank regulation, those safeguards do not apply to third-party fintech firms, which perform traditional lending functions beyond federal oversight.[176]

Several commentators attribute these costs to the fact that the bulk of entity-based regulation has focused on banks, rather than non-banks.[177] But the OCC's recent attempt to extend the entity-based framework to fintech firms directly by offering them special, non-depository bank charters has generated similar problems.[178] Originally proposed during the Obama administration, the OCC's fintech chartering program came into fruition under Trump.[179] In a 2016 white paper, the OCC described the initiative:[180] To be eligible, fintech firms had to lend money

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[173] *See* Bar-Gill & Warren, *supra* note 29, at 83 ("The problem is not in the federal preemption; it is in the failure of federal law to offer a suitable alternative to the preempted state law.").

[174] *See generally* Todd Zywicki, *Rent-Seeking, Crony Capitalism, and the Crony Constitution*, 23 SUP. CT. ECON. REV. 77, 89 (2015) ("Direct rent-seeking occurs when an interest group is provided with a benefit that directly benefits it, such as a tariff, regulated monopoly (such as a licensed profession), or subsidy, such as subsidies for particular agricultural commodities. These regulatory schemes typically also erect barriers to entry to prevent other parties from entering and dissipating the rents generated by the regulatory scheme.").

[175] *Cf.* Knight, *supra* note 24, at 132 ("Incongruous regulation could place new entrants at an undue disadvantage compared to their incumbent competitors and may deprive consumers of a fully competitive market.").

[176] *See* Jackson, *supra* note 8, at 14 ("While new fintech entrants have incentives to tap into the regulated sector for the bare minimum of activities, regulated entities also have incentives to 'push out' new fintech services into unaffiliated firms operating beyond the regulatory perimeter.").

[177] *See* Calomiris, *supra* note 3, at 403; Luther, *supra* note 58, at 1055-56; Murphy, *supra* note 62, at 407.

[178] *Cf.* Omarova, *supra* note 14, at 44-48 (describing the OCC's fintech charter program).

[179] Zaring, *supra* note 1, at 1400-01.

[180] OFFICE OF THE COMPTROLLER OF THE CURRENCY, EXPLORING SPECIAL PURPOSE NATIONAL BANK CHARTERS FOR FINTECH COMPANIES (Dec. 2016), https://www.occ.gov/publications-and-

or pay checks.[181] Chartered fintech firms would qualify as banks under the NBA and would therefore fall under its governance provisions.[182] Yet as *non-depository* banks, chartered fintech companies would not require FDIC deposit insurance, nor incur Community Reinvestment Act obligations.[183] Additionally, chartered fintech firms would not constitute "banks" for purposes of the Bank Holding Company Act, exempting them from a series of Federal Reserve regulations.[184] Although free from many of the burdens of traditional bank regulation, chartered fintech firms would receive the greatest benefit of federal recognition—the ability to export interest rates and preempt state licensing laws by invoking the NBA.[185]

The OCC's fintech chartering initiative became mired in litigation shortly after its launch. Both a national organization of state financial regulators[186] and the NYDFS[187] sued the OCC, contending the agency lacked the statutory authority to regulate non-depository fintech firms as banks under the NBA. The uncertain legal foundations of the OCC's program—combined with an opaque set of criteria for which applications the OCC would ultimate approve[188]—deterred fintech entrepreneurs from enrolling in the program. Indeed, the Second Circuit granted the OCC a fleeting victory in the NYDFS case by dismissing the case as unripe due to the lack of fintech charter

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resources/publications/banker-education/files/exploring-special-purpose-nat-bank-charters-fintech-companies.html.

181 *Id.* at 3.

182 *Id.* at 4.

183 *Id.* at 6.

184 *Id.* at 7.

185 *Id.* at 5; *see also* Cuttino, *supra* note 47, at 1536 ("[C]hartered FinTech firms could be able to export the usury laws of the state where they are organized to any state where they conduct business. They could also avoid state-by-state licensing requirements, process-specific regulations like disclosure rules, and service-term restrictions like loan-to-value ratios, payment schedules, and amortization.").

186 *CSBS Files New Complaint Against OCC*, CONF. STATE BANK SUPERVISORS (Dec. 22, 2020), https://www.csbs.org/newsroom/csbs-files-new-complaint-against-occ.

187 Vullo v. OCC, 378 F. Supp. 3d 271, 278 (S.D.N.Y. 2019).

188 *See* Brummer & Yadav, *supra* note 2, at 290-91.

applications.[189] But the ultimate legality of the OCC's initiative remains an open question.[190]

Although many commentators decried the OCC's fintech charter as "unprecedented,"[191] an appreciation of the dominant federal paradigm reveals that this initiative is in fact woefully traditional.[192] Notably, federal regulators have long recognized other non-traditional bank charters.[193] Yet more significantly, the OCC's fintech initiative retains the pathologies of the federal entity-based approach. The program displaces jurisdictional competition in governance matters, cutting short state innovation on a range of vexing fintech governance issues, such as the fiduciary duties of founders who serve as both CEOs and chairs of the board of directors.[194] Unlike in externality-intensive areas like consumer protection and prudential risk, state competition over governance provisions is desirable because these laws shape the relations between fintech entrepreneurs and their venture capital investors. A founder hoping to

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[189] Lacewell v. OCC, 999 F.3d 130, 134-35 (2d Cir. 2021).

[190] *See id.* at 150 ("Specifically, we do not address the district court's holding, on the merits, that the 'business of banking' under the NBA unambiguously requires the receipt of deposits . . . .").

[191] Menand & Ricks, *supra* note 116, at 44; Elizabeth J. Upton, *Chartering Fintech: The OCC's Newest Nonbank Proposal*, 86 GEO. WASH. L. REV. 1392, 1435 (2018); Sam Adriance, *Conference of State Bank Supervisors Sues to Stop OCC Fintech Charters*, COVINGTON: FIN. SERVS. (Apr. 27, 2017) ("CSBS President and CEO John Ryan stated, 'The OCC's action is an unprecedented, unlawful expansion of the chartering authority given to it by Congress for national banks.'"), https://www.covfinancial-services.com/2017/04/conference-of-state-bank-supervisors-sues-to-stop-occ-fintech-charters/.

[192] *Cf.* Mackenzie Humble, *A Natural Result: The Emergence of FinTech and SPNB Litigation*, COLUM. BUS. L. REV. (Aug. 13, 2019) ("[T]he debate over the [fintech charter] program has morphed into one centered around federalism, with the principal question asking to what extent may the OCC's authority displace state regulators' plenary power to regulate burgeoning industries within their borders."), https://journals.library.columbia.edu/index.php/CBLR/announcement/view/171.

[193] *See, e.g.*, Hughes, *supra* note 11, at 51 (describing industrial loan company charters).

[194] *See* Khakan Najaf, Alice Chin & Rabia Najaf, *Conceptualising the Corporate Governance Issues of Fintech Firms*, *in* THE FOURTH INDUSTRIAL REVOLUTION 187, 188 (Allam Hamdan et al., eds., 2021) (identifying fintech-specific governance issues such as "CEO duality" and "overboarded directors").

maximize venture capital investment in her firm therefore has a strong incentive to choose the optimal rule.[195]

Additionally, the OCC's fintech charter program will exacerbate regulatory arbitrage, since chartered fintech firms can engage in rent-seeking by selling their exportation privileges to non-chartered firms, just as banks currently do.[196] As a result, companies even further from the heartland of strict bank regulation could exploit the benefits of aggressive preemption. Finally, the OCC is unlikely to reverse course of its own accord, since it has structural incentives to increase its regulatory authority and fee base through progressively greater preemption.[197]

Thus, whether applied to banks or fintech firms, the prevailing federal strategy of entity-based preemption has resulted in exploitative arbitrage and hindered state innovation in fintech governance.

2. The Perils of Fragmentation

In the newer field of systemic risk controls, federal law has likewise adopted an entity-based approach unsuited to the emergent threats from fintech. When Congress enacted the current macroprudential framework on the heels of the 2008 financial crisis, large nonbanks like AIG and Lehman Brothers had recently demonstrated that centrally important firms could assume systemically significant risks while avoiding the strictures of bank oversight.[198] Legislators reacted to this gap in federal regulation in Dodd-Frank by creating the nation's first systemic risk regulator: the Financial Stability Oversight Council (FSOC).[199]

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[195] *See* Jensen & Meckling, *supra* note 26, at 312-13.
[196] *See supra* note 174 and accompanying text.
[197] *See generally* Timothy K. Armstrong, Chevron *Deference and Agency Self-Interest*, 13 CORNELL J.L. & PUB. POL'Y 203, 209-11 (2004) (examining the problem of agency self-interest in matters affecting "its own jurisdiction" and "own financial interest").
[198] *See* James Bullard, Christopher J. Nelly & David C. Wheelock, *Systemic Risk and the Financial Crisis: A Primer*, FED. RES. BANK ST. LOUIS REV., Sept.-Oct. 2009, 403, 411 n.21.
[199] *See* Jeffrey N. Gordon, *"Dynamic Precaution" in Maintaining Financial Stability: The Importance of FSOC*, *in* AFTER THE CRASH: FINANCIAL CRISES AND REGULATORY RESPONSES 142, 147 (Sharyn O'Halloran & Thomas Groll, eds., 2019).

Dodd-Frank's federal interventions into systemic risk were sorely needed. Prior microprudential controls designed to cabin risk at the level of individuals firms had proven inadequate to address the second-order risks posed by the interconnections among financial institutions.[200] Moreover, addressing systemic risk through state law is impracticable, since no single state government will internalize the full costs of regulated firms' risky activities on the national economy as a whole.[201]

Yet Dodd-Frank refused to vest FSOC with the autonomy and power enjoyed by peer agencies. Instead of structuring FSOC as a centralized hierarchy or partisan-balanced commission, Congress designed FSOC as a council comprised of other federal regulatory officials and chaired by the Treasury Secretary.[202] Thus, FSOC's governing body more closely resembles an informal interagency working group than a traditional agency.[203] Congress also limited FSOC's activities to the exercise of two primary powers: to designate firms as SIFIs, which then become subject to bank-like regulation by the Federal Reserve;[204] and to offer non-binding recommendations to other

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[200] *See* CONG. RES. SERV., R40417, MACROPRUDENTIAL OVERSIGHT: MONITORING SYSTEMIC RISK IN THE FINANCIAL SYSTEM 2 (2010) ("Monitoring these institutions for safety and soundness, which is referred to as microprudential oversight, does not directly address the challenges posed by systemic risk."), https://crsreports.congress.gov/product/pdf/R/R40417/4.

[201] *Cf.* Steven L. Schwarcz, *The Governance Structure of Shadow Banking: Rethinking Assumptions About Limited Liability*, 90 NOTRE DAME L. REV. 1, 15 (2014) (explaining that systemically risky activities generate "externalities"); Heedon Kang et al., *Macroprudential Policy Spillovers: A Quantitative Analysis* (Int'l Monetary Fund Working Paper No. 170, 2017) (manuscript at 32) ("Macroprudential policy measures taken to mitigate systemic risk in one regulatory jurisdiction can have macrofinancial effects on other jurisdictions. If these spillovers are significant, then policymakers should consider them when addressing systemic risks."), https://www.imf.org/en/Publications/WP/Issues/2017/07/24/Macroprudential-Policy-Spillovers-A-Quantitative-Analysis-45062.

[202] 12 U.S.C. § 5321(b) (2018).

[203] Robert F. Weber, *The FSOC's Designation Program as a Case Study of the New Administrative Law of Financial Supervision*, 36 YALE J. ON REG. 359, 378 (2019) ("[T]he FSOC bears a resemblance to less formally constituted groupings of regulators, such as interagency working groups or supervisory colleges.").

[204] 12 U.S.C. § 5323(a)(1) (2018).

financial regulators on how to promote macroeconomic stability.[205]

During the Obama administration, FSOC exercised its statutory authority by designating several non-banks as SIFIs.[206] But the compliance costs associated with SIFI status were so severe[207] that firms either restructured their business to avoid the label[208] or defeated FSOC's decision through litigation.[209] Today, there are no longer any designated SIFIs.[210]

While FSOC's statutory powers are a sensible means of preventing the macroprudential risks that fueled the 2008 financial crisis, this entity-based framework is ill suited to address the systemic risks of fintech. FSOC's designation authority is irreducibly binary—either an enterprise is a SIFI or not.[211] Furthermore, conditioning regulatory obligations on firm-level distinctions "fits comfortably within traditional entity-based schemes of [federal] financial regulation."[212] Thus, small

[205] *Id.* § 5322(a)(2)(K).
[206] *See* Jeremy C. Kress, Patricia A. McCoy & Daniel Schwarcz, *Regulating Entities and Activities: Complementary Approaches to Nonbank Systemic Risk*, 92 S. CAL. L. REV. 1455, 1474 (2019).
[207] *See* Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Nonbank Problem*, 84 U. CHI. L. REV. 1813, 1817 (2017).
[208] *See* Ted Mann & Ryan Tracy, *GE Capital Sheds "Systemically Important" Label*, WALL ST. J. (June 29, 2016) ("Because GE had shrunk and restructured the business, the U.S. Financial Stability Oversight Council said Wednesday it had voted to remove GE's designation as a 'systemically important' financial institution, a label that had required the company to submit to stricter rules and supervision by the Federal Reserve."), https://www.wsj.com/articles/ge-capital-sheds-systemically-important-label-for-too-big-to-fail-firms-1467205963.
[209] MetLife, Inc. v. FSOC, 177 F. Supp. 3d 219, 223 (D.D.C. 2016) (rescinding MetLife's SIFI designation as arbitrary and capricious).
[210] *See* Jeremy C. Kress, *The Last SIFI: The Unwise and Illegal Deregulation of Prudential Financial*, 71 STAN. L. REV. ONLINE 171, 175 (2018) ("And with that, that last remaining nonbank SIFI escaped federal oversight, and nonbank SIFI designations—a key post-crisis regulatory tool— fell into complete disuse.").
[211] Christina Parajon Skinner, *Regulating Nonbanks: A Plan for SIFI Lite*, 105 GEO. L.J. 1379, 1396 (2017).
[212] Kress, McCoy & Schwarcz, *supra* note 206, at 1459.

financial service firms engaged in systemically risky activities fall beyond FSOC's coercive reach.[213]

But academics have increasingly raised alarm at the macroprudential fragility of a financial sector fragmented by fintech.[214] Due to disaggregation and disintermediation, financial service supply chains are now often comprised of numerous small, specialized firms.[215] Yet small fintech companies lack the risk management infrastructure[216] and reputational stakes[217] that discipline excessive risk-taking in traditional financial institutions. Fragmented supply chains also entail greater connections between firms, creating potential conduits for the propagation of shocks.[218] Failure at a choke point could therefore materialize counterparty risks, with cascading defaults downstream.[219] Cybersecurity is an especially concerning vulnerability in the fintech ecosystem, since a hack at one firm

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[213] *See id.* at 1523 ("FSOC's entity-based approach cannot effectively mitigate systemic risk arising from correlations among numerous smaller companies."); CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 22.

[214] *See, e.g.*, Magnuson, *supra* note 5, at 1171; Saule T. Omarova, *New Tech v. New Deal: Fintech as a Systemic Phenomenon*, 36 YALE J. ON REG. 735, 742 (2019).

[215] *See supra* notes 7-8 and accompanying text; Schwarcz, *supra* note 201, at 18.

[216] *Cf.* Brummer & Yadav, *supra* note 2, at 281 ("[W]here such small firms operate as part of longer or more fragmented supply chains, any single firm within the supply chain will likely lack the incentive to police its functioning.").

[217] Magnuson, *supra* note 5, at 1199 ("[F]intech firms, because of their small size and dispersed nature, are less restricted by reputational constraints 'than large financial institutions.").

[218] *See* Daron Acemoglu, Asuman Ozdaglar & Alierza Tahbaz-Salehi, *Systemic Risk and Stability in Financial Networks*, 105 AM. ECON. REV. 564, 566 (2015) ("[W]ithin a certain range, connections serve as shock-absorbers and connectivity engenders robustness. However, beyond that range, interconnections start to serve as a mechanism for the propagation of shocks, the system flips to the wrong side of the knife-edge, and fragility prevails." (internal quotation marks omitted)).

[219] Kress, McCoy & Schwarcz, *supra* note 206, at 1470 ("Systemic risk spreads through the counterparty channel when a firm defaults on its financial obligations to counterparties and saddles them with losses."); *see also* Skinner, *supra* note 211, at 1418 ("This chain of events should sound familiar: it is a fintech variation on the classic depositor bank run or liquidity crunch.").

could produce a contagion effect throughout an interconnected financial sector.[220]

Thus, the fixation on large SIFIs that defines Dodd-Frank's entity-based approach to systemic risk regulation is incongruous with today's disaggregated and disintermediated financial sector.[221]

II. The New Fintech Federalism

The repeated failures of the traditional paradigm have kindled an unremarked revolution in the federal-state division of responsibilities over fintech firms. Under the prevailing framework, states utilize activities-based mandates to police consumer protection and safety and soundness,[222] while federal regulators employ an entity-based regime to supply governance rules and curb systemic risk.[223] But in the past decade, several legal innovations have rejected this longstanding approach and refashioned state-federal relations in a manner that reduces the compliance costs and externalities of the traditional paradigm.

The New Fintech Federalism reverses the core responsibilities of the state and federal governments: states embrace an entity-based regime to structure fintech governance and the federal government regulates activities in the externality-heavy areas of consumer protection and prudential risk.

Many of the reforms explored in this Part are nascent, arising only at the edges of a policy discourse that remains committed to the prevailing approach. But these developments possess the potential to radically improve American financial regulation by crafting a fairer and more efficient regime for

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[220] *See, e.g.*, Hilary J. Allen, *Payments Failure*, 62 B.C. L. REV. 453, 455 (2021); Ross P. Buckley et al., *The Dark Side of Digital Financial Transformation: The New Risks of FinTech and the Rise of TechRisk* (Eur. Banking Inst. Working Paper No. 54, 2019) (manuscript at 13) ("Cybersecurity has become one of the leading areas of attention of financial regulators around the world as well as of governments and financial and tech firms. We would suggest that cybersecurity is now the most significant source of systemic risk, as well as one of the more significant issues of national security."), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3478640.
[221] *Cf.* Skinner, *supra* note 211, at 1418 ("Perhaps nowhere more apparent is the need for a flexible designation tool than in the fintech sector.").
[222] *See supra* Section I.A.
[223] *See supra* Section I.B.

entrepreneurs and consumers alike. Capitalizing on the best aspects of state competition and federal leadership, the New Fintech Federalism promises to turn the distinctive essence of U.S. financial regulation—federalism[224]—from a millstone into a valuable asset for domestic policy and global competition.

A. Entity-Based, Reciprocal State Law

Rather than focusing exclusively on intrastate financial activities, state officials have moved towards a framework of reciprocal recognition that allows fintech firms authorized to operate in one state to seamlessly offer services in other jurisdictions. By regulating at the level of mutually acknowledged firms, state initiatives are entity-based in a manner analogous to chartering.[225] This departure from states' traditional purview promotes innovation by reducing compliance costs.[226] Moreover, when cabined by appropriate federal regulation of externality-intensive activities, this approach harnesses the benefits of jurisdictional competition for superior legal rules to attract chartering fees.[227]

1. Multi-State Cooperation

The most successful efforts to promote entity-based reciprocity in state law have resulted from multilateral coordination among state officials. Most of these initiatives originated

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[224] *See, e.g.*, Emmette S. Redford, *Dual Banking: A Case Study in Federalism*, 31 L. & CONTEMP. PROBS. 749, 749 (1966) (describing the federalist structure of U.S. financial regulation as "a distinctive pattern in American federalism").

[225] *E.g.*, CONF. OF STATE BANK SUPERVISORS, CSBS VISION 2020: A PROGRESS REPORT 2 (Apr. 25, 2020) ("In 2017, state regulators made it [their] policy to move towards an integrated, 50-state system of licensing and supervision for nonbanks."), https://www.csbs.org/print/pdf/node/19021.

[226] *See* Brian D. Christiansen et al., *A Look at US and EU Fintech Regulatory Frameworks*, SKADDEN (Feb. 16, 2018) ("Efforts to streamline state-level regulation will be particularly important for fintech companies, given that a decentralized financial system with a myriad of regulatory bodies and a fragmented legal environment increases compliance costs."), https://www.skadden.com/insights/publications/2018/02/a-look-at-us-and-eu-fintech-regulatory-frameworks

[227] *Cf.* Brian Knight, *Fintech: Who Regulates It and Why It Matters*, MILKEN INST. 20 (Apr. 2016) (assessing the costs and benefits of jurisdictional competition in fintech regulation), https://milkeninstitute.org/sites/default/files/reports-pdf/FinTech-Who-Regulates-It-and-Why-It-Matters2.pdf.

with a single organization: the Conference of State Bank Supervisors (CSBS).[228] A non-governmental organization comprised of the financial regulators from ever state and several territories,[229] CSBS is a translocal organization of government actors, offering a distinctive alternative to federal or single-state institutions and enriching national deliberations.[230]

CSBS has recognized that the heavy costs from territorial regulations of non-banks have proven problematic for fintech firms.[231] This concession was likely tactical, since innovation-hampering compliance costs from state regulation increase the threat that federal officials will intervene and wrest authority from CSBS's members.[232] Regardless, CSBS has been a leading proponent of greater coordination and reciprocity in state financial regulation from the 1990s[233] through today.[234] CSBS argues that a cooperative approach increases competition,[235] yet maintains the benefits of state experimentation.[236]

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[228] *See* Hughes, *supra* note 11, at 54.
[229] *What Is the Conference of State Bank Supervisors?*, CONF. STATE BANK SUPERVISORS, https://www.csbs.org/home.
[230] *See* Judith Resnik et al., *Ratifying Kyoto at the Local Level: Sovereigntism, Federalism, and Translocal Organizations of Government Actors (TOGAs)*, 50 ARIZ. L. REV. 709, 766 (2008) ("By amplifying state and local voices through these networks and thereby generating political capital for the jurisdictional office-holders and entities they denote, the views of differing kinds of subnational actors are made known.").
[231] *See* CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 24.
[232] Hill, *supra* note 4, at 63; Luther, *supra* note 58, at 1034-35 (arguing a CSBS harmonization initiative "seems to be an effort, in part, to rebut attempts by federal banking regulators to extend chartering to nonbank fintech firms").
[233] *See State Regulators: A History of Building Solutions Together*, CONF. STATE BANK SUPERVISORS (Feb. 18, 2019), https://www.csbs.org/newsroom/state-regulators-history-building-solutions-together.
[234] *See* CONF. OF STATE BANK SUPERVISORS, *supra* note 225, at 5 (describing the organization's goal of "multistate harmonization").
[235] *CSBS Announces Vision 2020 for Fintech and Non-Bank Regulation*, CONF. STATE BANK SUPERVISORS (May 10, 2017) (describing "the vision for a more streamlined state regulatory system that supports business innovation, local and national economic growth, and essential protections for consumers and taxpayers."), https://www.csbs.org/newsroom/csbs-announces-vision-2020-fintech-and-non-bank-regulation.
[236] *License to Bank*, *supra* note 45, at 2 ("[T]he state system encourages creativity, experimentation, diversity and choice, all of which enhance local economic development, market competition and business flexibility.").

CSBS's first major act of coordination in non-bank regulation was the creation of the Nationwide Mortgage Licensing System (NMLS), a regulatory technology[237] platform that allows examiners to share their findings, thereby reducing information costs and service fees.[238] By 2008, regulators in every state adopted the NMLS.[239] Congress required federal regulators to utilize the NMLS as well in 2011.[240] The NMLS was so successful that CSBS renamed it the National *Multistate* Licensing System and expanded it to money transmitters, consumer lenders, and debt collectors.[241] Although an exciting first step, the NMLS was not a panacea; the platform did not issue reciprocal licenses. Rather, the NMLS merely enabled each state to share information while setting their own standards and rendering their own licensing decisions.[242]

In a further step towards interstate mutuality, CSBS pioneered the Money Services Business (MSB) Licensing Agreement.[243] This multistate agreement provides that each signatory will accept other signatories' determinations of key elements in MSBs' licensing applications, such as the quality of their business plans, cybersecurity infrastructure, and anti-money laundering controls.[244] Today, 29 states have joined the initiative,

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[237] For a celebration of the benefits of regulatory technology, see Douglas W. Arner et al., *FinTech, RegTech, and the Reconceptualization of Financial Regulation*, 37 NW. J. INT'L L. & BUS. 371, 376 (2017).

[238] *License to Bank*, *supra* note 45, at 2; Luther, *supra* note 58, at 1035.

[239] U.S DEP'T OF TREAS., A FINANCIAL SYSTEM THAT CREATES ECONOMICS OPPORTUNITIES: NONBANK FINANCIALS, FINTECH, AND INNOVATION 68 (July 2018), https://home.treasury.gov/sites/default/files/2018-08/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financials-Fintech-and-Innovation.pdf.

[240] *See* Douglas, *supra* note 44, at 33; McQuinn, *supra* note 97, at 4.

[241] U.S. DEP'T OF TREAS., *supra* note 239, at 68; Fernando Restoy, *Fintech Regulation: How to Achieve a Level Playing Field* 12 (Fin. Stability Inst. Paper No. 17, 2021), https://www.bis.org/fsi/fsipapers17.pdf.

[242] CONF. OF STATE BANK SUPERVISORS, *supra* note 59, at 58 ("Each state nonbank regulator holds the legal authority to license. Although CSBS owns and manages the system, neither CSBS nor NMLS grant or deny licenses."); *see also* Lo, *supra* note 14, at 118 (observing that despite NMLS, "each state still retains its own unique licensing requirements").

[243] *State Regulators Take First Step to Standardize Licensing Practices for Fintech Payments*, CONF. STATE BANK SUPERVISORS (Feb. 6, 2018) [hereinafter, *First Step*], https://www.csbs.org/newsroom/state-regulators-take-first-step-standardize-licensing-practices-fintech-payments; *see* Restoy, *supra* note 241, at 12; Zaring, *supra* note 1, at 1456.

[244] *License to Bank*, *supra* note 45, at 6; *First Step*, *supra* note 243; *see* Ctr. for Cap. Markets Competitiveness, *supra* note 25, at 41.

ranging from major markets like California and Texas to smaller states as divergent as South Dakota and Connecticut.[245] Though each state retains final say over whether to grant an MSB license, the program eliminates the unnecessary repetition of basic investigations by each state regulator and reduces the delays fintech firms experience when applying for licenses in multiple states.[246]

Finally, CSBS recently launched a single, comprehensive MSB examination that satisfies supervision requirements in 40 states.[247] Because the program remains in its pilot phase, CSBS offers the examination only to large payment firms.[248] Nevertheless, 13 MSBs have enrolled in the program and a PayPal executive praised the initiative as "transformative."[249] By extending a single jurisdiction's authorization across the vast majority of states, the "One Company, One Exam" program represents the closest the United States has ever come to reciprocity in non-bank financial regulation.

Despite CSBS's leadership in the field, other organizations have also sought to reduce the compliance costs from the state-by-state regulation of fintech firms. The Uniform Law Commission drafted the Uniform Money Services Act in 2004 with the stated goal of creating a "simple and consistent set of licensing requirements" to replace the "varied and complex regulatory system" governing online MSBs.[250] The Act covers

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[245] *See Multistate MSB Licensing Agreement Program*, NMLS RESOURCE CTR. (accessed Aug. 31, 2021), https://nationwidelicensingsystem.org/slr/Pages/Multistate-MSB-Licensing-Agreement-Program.aspx.

[246] *See First Step*, *supra* note 243 ("This MSB licensing agreement will minimize the burden of regulatory licensing [and] use state resources more efficiently . . . ." (quoting John Ryan, CSBS president)).

[247] *State Regulators Roll out One Company, One Exam for Nationwide Payment Firms*, CONF. STATE BANK SUPERVISORS (Sept. 15, 2020), https://www.csbs.org/newsroom/large-fintechs-and-other-payments-companies-move-single-exam-nationwide-regulatory.

[248] *See License to Bank*, *supra* note 45, at 6; Hill, *supra* note 4, at 63.

[249] *Large Fintechs and Other Payments Companies Move to a Single Exam for Nationwide Regulatory Compliance*, CONF. STATE BANK SUPERVISORS (Mar. 22, 2021), https://www.csbs.org/newsroom/large-fintechs-and-other-payments-companies-move-single-exam-nationwide-regulatory.

[250] UNIF. MONEY SERVS. ACT, prefatory note (UNIF. LAW COMM'N 2004).

licensing requirements,[251] examination procedures,[252] and penalties for non-compliance.[253] Though bold in its aims, the Act's practical import has been limited, since only 10 states and 2 territories have enacted it.[254] Nevertheless, the Uniform Law Commission's efforts speak to an animating anxiety about the costs of inconsistent state laws.

Through numerous acts of multilateral coordination, state officials have rejected the prevailing state-by-state paradigm in fintech regulation. In its place, these organizations and officials have marched towards an entity-based framework of mutual recognition that reduces compliance costs and enhances competition in the financial sector.

2. Unilateral State Action: The Evolving Case of Cryptocurrency

A handful of state officials have instead undertaken unilateral measures to achieve reciprocity in fintech regulation. This nascent strategy is most evident in the growing field of cryptocurrency law. While the financially significant state of New York was the first to establish a cryptocurrency licensing regime,[255] smaller states have proceeded gingerly, aware that adopting inconsistent laws might lead firms to refuse to serve customers in their jurisdictions.[256]

Louisiana responded to the small states' dilemma with a novel statute. The Louisiana Virtual Currency Businesses Act of 2020 largely resembles New York's BitLicense program, as it requires firms engaged in specified cryptocurrency activities

[251] *Id.* art. 2.
[252] *Id.* art. 6.
[253] *Id.* art. 8.
[254] *See Money Services Act*, UNIF. L. COMM'N (accessed Aug. 31, 2021) (tracking the Act's passage), https://www.uniformlaws.org/committees/community-home?CommunityKey=cf8b649a-114c-4bc9-8937-c4ee17148a1b.
[255] *See supra* notes 89-95 and accompanying text.
[256] *Cf.* Jen Fifield, *Tiny Towns, Small States Bet on Bitcoin Even as Some Shun Its Miners*, PEW (Apr. 6, 2018) (describing how large and small states have approached cryptocurrency regulation differently), https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2018/04/06/tiny-towns-small-states-bet-on-bitcoin-even-as-some-shun-its-miners.

to procure licenses[257] and undergo regular examinations.[258] But while the law maintains these hallmarks of the traditional approach, the statute also "authorize[s] reciprocity of licensure"[259] by empowering the state's Office of Financial Institutions to enter "arrangement[s] between the department and the appropriate licensing agency of another state which permit[] a licensee operating under a license granted by the other state to engage in virtual currency business activity with or on behalf of a [Louisiana] resident."[260] Thus, although the statute is still in its earliest days of implementation[261] and retains several aspects of the traditional entity-based regime, Louisiana's embrace of reciprocity represents an significant step away from the prevailing approach and towards a more unified, entity-based regime for fintech firms.

Nor is Louisiana the only state to consider a reciprocal legal regime for cryptocurrency. New Jersey legislators introduced a similar bill, which would allow cryptocurrency businesses licensed in states with which New Jersey has entered reciprocity agreements to offer services to New Jersey residents.[262] The bill was designed to ease the interstate compliance burden on New York BitLicense holders to encourage them to operate across the Hudson River.[263]

Unilateral initiatives are still nascent and are unlikely to generate a nationwide entity-based regime for cryptocurrency. But state legislators' willingness to forgo the territorial, activities-based regime that has defined state non-bank regulation since the Founding is a remarkable development—one that speaks to the powerful economic dynamics pushing officials towards the New Fintech Federalism.

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[257] LA. REV. STAT. ANN. § 6:1384 (2021).
[258] *Id.* § 6:1391.
[259] H.B. 701, Reg. Session. (La. 2020).
[260] LA. REV. STAT. ANN. § 6:1382(10).
[261] As it drafts implementing regulations, the Office of Financial Institutions has not yet entered into a reciprocity agreement with another financial regulator. *See* Sarah Edwards, *Louisiana to Require Virtual Currency Business License*, JD SUPRA (Aug. 6, 2020), https://www.jdsupra.com/legalnews/louisiana-to-require-virtual-currency-11369/.
[262] A.2891, 219th Gen. Assemb., § 3(a)(2) (N.J. 2020).
[263] *See* Lin Pang & Guy E. Flynn, *New Jersey Considers Crypto License Bill*, DLA PIPER (Dec. 22, 2020), https://www.dlapiper.com/en/us/insights/publications/2020/12/new-jersey-senate-considers-crypto-license-bill/.

3. Passporting in a Shifted Discourse

States' coordinated and unilateral legal reforms reflect an emerging consensus among policy experts that the prevailing state-by-state, activities-based approach to fintech regulation is no longer viable. In 2018, the U.S. Treasury Department issued a report criticizing the "unnecessary inconsistencies across state laws and regulations."[264] Citing the benefits of the CSBS's reciprocity initiatives,[265] the Treasury Department proposed a bolder solution still: a passporting system,[266] under which a fintech firm recognized by one jurisdiction can then automatically operate nationwide.[267]

Academic commentators and policy professionals have similarly called for a passporting approach in recent years.[268] Indeed, the European Union already has a passporting system for fintech firms operating within its member states.[269] Proponents argue that passporting eliminates the onerous compliance costs fintech firms face when complying with inconsistent state laws, thereby fostering innovation.[270]

Critics of passporting have replied that national harmony requires a degree of unanimity among the states that is unlikely to materialize.[271] Moreover, given the current posture of federal regulation, a passporting regime would allow fintech firms to export state laws even in externality-heavy areas such as consumer protection and safety and soundness.[272] This creates a

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[264] U.S. DEP'T OF TREAS., *supra* note 239, at 70.

[265] *Id.* at 68 (describing the successes of the NMLS).

[266] *Id.* at 70 ("Passporting represents a path through which states could effectuate a system of licensing that is conducive to a national business model while still retaining oversight at the state level.").

[267] *Id.* at 70.

[268] *See, e.g.*, Verret, *supra* note 109, at 33; Jerry Brita & Andrea Castillo, *Bitcoin: A Primer for Policymakers*, MERCATUS CTR. 54 (2016), https://www.mercatus.org/system/files/gmu_bitcoin_042516_webv3_0.pdf.

[269] *See* Matthias Lehmann, *Global Rules for a Global Market Place? Regulation and Supervision of Fintech Providers*, 38 B.U. INT'L L.J. 118, 149-50 (2020).

[270] *See* U.S. DEP'T OF TREAS., *supra* note 239, at 70.

[271] Lo, *supra* note 14, at 146; *see also* Brita & Castillo, *supra* note 268, at 54 ("[F]or reciprocity and sharing agreements to be effective, they will require a level of interstate consensus that may be difficult to achieve . . . .").

[272] *Cf.* Luther, *supra* note 58, at 1038 ("[I]f we are to rely on the CSBS plan to ensure nationwide consumer protection, then every state must express the same commitment."); Lehmann, *supra* note 269, at 150 (arguing that

collective action problem among states.[273] As in a prisoner's dilemma, every state would be better off cooperating to ensure adequate consumer protection and prudential laws apply to fintech firms; however, each state has an individual incentive to defect by cutting legal safeguards, externalizing the costs of this laxity on other states, and reaping the rewards of greater chartering fees.[274]

The chorus of officials, academics, and policy experts championing a passporting regime reveals a growing discontent with the prevailing territorial approach to fintech regulation among the states. Although passporting proposals are unlikely—and in certain respects undesirable without federal guardrails—they represent the fullest repudiation of the current paradigm to date and the clearest call for an entity-based approach among the states.

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Through several initiatives, state governments and policy experts have departed from the prevailing activities-based approach to state fintech regulation in favor of entity-based reciprocity. Collectively, these developments constitute a pillar of the New Fintech Federalism and offer several key benefits over the prior paradigm.

Mutual recognition among the states eases the daunting compliance burden on fintech firms,[275] freeing up their scarce startup capital to fund product development and other growth areas. Encouraging interstate operations also fosters the creation of a national market for fintech[276] that reflects the

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under the EU's passporting regime, fintech firms are "incited to engage in regulatory arbitrage. . . [because] a state could become the financial hub for an entire region and externalize the costs to others").

[273] For a seminal analysis of collective action problems among the states, see Robert D. Cooter & Neil S. Siegel, *Collective Action Federalism: A General Theory of Article I, Section 8*, 63 STAN. L. REV. 115, 117 (2010).

[274] *Cf.* Louis Michael Seidman, *Depoliticizing Federalism*, 35 HARV. J.L. & PUB. POL'Y 121, 125 (2012) (discussing "the prisoner's dilemma . . . [when] the citizens of individual states want to develop a particular regulatory regime, but competition between states prevents them from doing so").

[275] *See infra* Section I.A.

[276] McQuinn & Castro, *supra* note 9, at 1.

interjurisdictional nature of digital commerce and benefits consumers in smaller states that otherwise might not be worth serving.

Reducing the barrier to entry posed by inconsistent state laws bolsters competition in the U.S. financial sector, empowering new entrants to challenge incumbent banks with better products and services.[277] A more dynamic market for financial services benefits national interests as well by promoting the innovation necessary to ensure the United States remains globally competitive in fintech.[278]

Reciprocal fintech regulation also creates a salutary competition among the states for superior legal regimes to attract fintech charters. As long as externality-intensive activities are policed by the federal government,[279] states can vie for dominance in the domains in which the states are well situated to weigh the full costs and benefits of their rules—namely, governance rules chosen by fintech entrepreneurs seeking outside capital.[280] This competition will enhance the deliberative richness of America's democratic discourse, providing a fertile ground for state experimentation and generating diverse legal solutions to pressing problems.[281]

Finally, successful competitors for charters in a reciprocal fintech regime are unlikely to be large jurisdictions with robust economies. Just as small states like Delaware can credibly commit to high-quality governance rules in corporate law due to their lack of alternative revenue sources,[282] the jurisdictions poised to attract fintech charters most effectively are smaller

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[277] *See* Zaring, *supra* note 1, at 1469 ("[E]nabling new entries into the financial system should increase competition and impose market discipline on financial firms, an outcome which has long been a goal of regulatory policy and one espoused by all regulators . . . .").
[278] *Cf.* Exec. Order No. 14036, 86 Fed. Reg. 36987, 36987 (July 14, 2021) ("Robust competition is critical to preserving America's role as the world's leading economy.").
[279] *See infra* Section II.B.
[280] *See* Jensen & Meckling, *supra* note 26, at 312-13; Winter, *supra* note 118, at 290.
[281] *Cf.* Robert M. Cover, *The Uses of Jurisdictional Redundancy: Interest, Ideology, and Innovation*, 22 WM. & MARY L. REV. 639, 673 (1981) ("This proliferation of norm-generating centers also makes it more likely that at least one such center will attempt any given, plausible innovation.").
[282] Roberta Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J.L. ECON. & ORG. 225, 235 (1985).

states in need of economic development. Indeed, rural states like South Dakota and Wyoming have already become pioneers in fintech regulation.[283] The New Fintech Federalism could therefore provide a boon to such states during an era of interstate inequality.[284]

But the benefits of interjurisdictional competition for fintech charters should not be limited to states. Although too often exploited by fintech firms engaged in arbitrage, tribes have shown a strong interest in fintech regulation.[285] Much like small states with a demonstrated commitment to fintech firms, tribes are in a strong position to attract charters. Fees from fintech have already bolstered tribal economies[286] that are otherwise struggling.[287] Moreover, the United States as a whole would benefit from tribal innovation in fintech law, since state and federal courts would gain a deeper appreciation of the distinctive structures, norms, and processes of tribal governments.[288]

Thus, the nascent shift in state fintech regulation from an activities- to an entity-based paradigm is a promising development, both economically and politically.

B. Activities-Based Federal Law: Casting a Wider Net

Federal officials have demonstrated a growing willingness to regulate financial activities directly, rather than merely the entities that traditionally performed them. Empowering federal regulators to oversee the actions of non-banks has enabled

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[283] *See* Omarova, *supra* note 14, at 46.
[284] For a thoughtful examination of the federalism implications of resource disparities between states, see Robert A. Schapiro, *States of Inequality: Fiscal Federalism, Unequal States, and Unequal People*, 108 CALIF. L. REV. 1531, 1538 (2020).
[285] *See* Nanini, *supra* note 144, at 503-05.
[286] Gavin Clarkson, Katherine A. Spilde & Carma M. Claw, *Online Sovereignty: The Law and Economics of Tribal Electronic Commerce*, 19 VAND. J. ENT. & TECH. L. 1, 26 (2016) ("In many cases, lending operations have become the center of a reservation's economy and are one of the most significant employers of tribal members.").
[287] *Id.* at 9 ("With over one-quarter of American Indians living in poverty—nearly twice the national average—it has never been more important to promote confidence in the Indian economy.").
[288] *Cf.* Judith Resnik, *Dependent Sovereigns: Indian Tribes, States, and the Federal Courts*, 56 U. CHI. L. REV. 671, 758 (1989) ("Thus far, the official canon of the federal courts has not included the relationship between the federal courts and Indian tribes.").

policymakers to grapple with fintech-related challenges that eluded the prevailing, entity-based framework. Specifically, this fundamental shift in strategy reduces regulatory arbitrage and state collective action problems, yet preserves a deliberative role for citizens of small states.

The long march towards an activities-based federal regime for fintech firms has its roots in the post-crisis legislative interventions of Dodd-Frank, prior to fintech's ascendency. But while the fintech industry was just budding during the Act's enactment, Dodd-Frank's drafters expressly framed their statutory interventions as a response to the threat of fintech. Articulating the "need for legislation," the Senate Banking Committee explained: "Technology, plus globalization, plus finance has created something quite new, often called 'financial technology.' Its emergence is a bit like the discovery of fire—productive and transforming when used with care, but enormously destructive when mishandled."[289] More than Dodd-Frank's drafters appreciated at the time, their departures from the prevailing federal approach set the stage for a radical shift in federal fintech regulation.

This Part traces that ongoing transformation. After discussing efforts to curb the aggressive approach to preemption long championed by federal bank regulators, this Part examines the federal government's activities-based forays into three externality-intensive areas: consumer protection, safety and soundness, and systemic risk.

1. Curbing Preemption

Congress turned against the prevailing strategy of ever-greater preemption for federally favored entities following the financial crisis. After the OCC and OTS embraced aggressive preemption in their 2004 regulations, banks as well as their subsidiaries and partners invoked preemption to avoid a wide array of state laws.[290] But once the housing market crashed in

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[289] S. REP. NO. 111-176, at 43 (2010) (quoting *Turmoil in the U.S. Credit Markets: The Genesis of the Current Economic Crisis: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 110th Cong. 19 (2008) (statement of Eugene Ludwig, CEO of Promontory Financial and former Comptroller of the Currency)).

[290] *See* Arthur E. Wilmarth Jr., *The OCC's Preemption Rules Exceed the Agency's Authority and Present a Serious Threat to the Dual Banking System and Consumer Protection*, 23 ANN. REV. BANKING & FIN. L. 225, 363-64 (2004).

2008, academics and politicians began to criticize the federal preemption strategy, contending it eroded consumer protection and contributed to the overextension of subprime debt.[291]

Dodd-Frank translated commentators' frustrations with federal bank regulators into statutory restrictions on future attempts to preempt state law.[292] Congress provided that "state consumer financial laws" would not be preempted unless they conflicted with federal law,[293] thereby codifying the applicability of conflict preemption and rejecting OTS's field preemption theory.[294] Dodd-Frank also overturned the Supreme Court decision applying preemption to national banks' operating subsidiaries.[295]

Although the OCC can still exercise its regulatory authority to declare certain state laws preempted, it can only do so on a "case-by-case basis"[296] after consulting the newly created Consumer Financial Protection Bureau (CFPB).[297] But even after satisfying this statutory hurdle, the OCC's preemption decisions are not entitled to *Chevron* deference.[298] Since *Chevron* is merely a presumption of legislative intent, Congress remains free to alter its applicability.[299] Accordingly, Dodd-Frank instructed courts reviewing OCC preemption decisions to instead

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291 *E.g.*, Patricia A. McCoy, Andrey D. Pavlov & Susan M. Wachter, *Systemic Risk Through Securitization: The Result of Deregulation and Regulatory Failure*, 41 CONN. L. REV. 493, 523 (2009); Eliot Spitzer, Opinion, *Predatory Lenders' Partner in Crime*, WASH. POST (Feb. 14, 2008), https://www.washingtonpost.com/wp-dyn/content/article/2008/02/13/AR2008021302783.html.

292 *See License to Bank*, *supra* note 45, at 5.

293 12 U.S.C. § 25b(b)(1)(B) (2018).

294 Indeed, Dodd-Frank abolished OTS altogether, *see* 12 U.S.C. § 5412, amid claims that the financial industry had captured the agency. *See, e.g.*, Lawrence G. Baxter, *"Capture" in Financial Regulation: Can We Channel It Towards the Common Good?*, 21 CORNELL J.L. & PUB POL'Y 175, 181 (2011) (describing a Senate report reprimanding OTS's laxity).

295 12 U.S.C. § 25b(e).

296 *Id.* § 25b(b)(1)(B).

297 *Id.* § 25b(b)(3)(B).

298 *See id.* § 25b(c).

299 *See* Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 844 (1984) ("Sometimes the legislative delegation to an agency on a particular question is implicit rather than explicit. In such a case, a court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.").

utilize the four factors of *Skidmore* deference.[300] Though scholars and jurists debate the contours of the *Chevron* and *Skidmore* doctrines,[301] *Skidmore* is undeniably a less deferential standard, making judicial reversals of OCC preemption decisions more likely.[302]

By limiting federal regulators' ability to preempt state laws, Dodd-Frank marked a decisive blow against the prevailing approach to financial regulation since *McCulloch*.[303] Yet Congress failed to eliminate the most problematic outgrowth of NBA preemption: the interest rate exportation doctrine.[304] Thus, in preventing future incursions, Dodd-Frank left in place the OCC's prior forays into the preemption of state financial laws. Rent-a-bank schemes therefore continued unabated, generating precisely the kind of subprime debts that Dodd-Frank ostensibly sought to keep out of the nation's secondary credit markets.[305]

Though imperfect, Dodd-Frank's preemption provisions constituted a significant step in the development of a new federal paradigm. Rejecting the aggressive preemption strategy that had faltered in its treatment of non-banks in the twenty-first century, Congress paved the way for an unprecedent federal focus on financial activities.

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[300] 12 U.S.C. § 25b(b)(5)(A); *see* Kent Barnett, *Codifying* Chevmore, 90 N.Y.U. L. REV. 1, 4 (2015) (explaining how Dodd-Frank's statutory standard mirrors the factors announced in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944)).

[301] *See, e.g.*, United States v. Mead Corp., 533 U.S. 218, 250 (2001) (Scalia, J., dissenting) ("[T]he rule of *Skidmore* deference is an empty truism and a trifling statement of the obvious: A judge should take into account the well-considered views of expert observers.").

[302] Bogert, *supra* note 12, at 323 ("*Skidmore* deference as opposed to *Chevron* deference makes any OCC rulemakings less likely to pass judicial review . . . .").

[303] Hills, *supra* note 113, at 1289 ("[Dodd-Frank's] requirements for preemption determinations further suggest the rejection of broad *McCulloch*-style preemption."); *see also* Bogert, *supra* note 12, at 325 ("[Dodd-Frank] departs from our Dual Banking system and the Federalism benefits that this system guarantees.").

[304] Lauren Saunders, *The Role of the States Under the Dodd-Frank Wal Street Reform and Consumer Protection Act of 2010*, NAT'L CONSUMER L. CTR. 8 (Dec. 2010) ("The Dodd-Frank Act does not change interest rate exportation."), https://www.nclc.org/images/pdf/legislation/dodd-frank-role-of-the-states.pdf.

[305] *See supra* notes 145-147 and accompanying text.

2. Consumer Protection

Dodd-Frank's more drastic contribution to the New Fintech Federalism went beyond hindering the propagation of the prior paradigm; rather, it cut at the very fabric of our financial federalism by federalizing a vast field long considered the heartland of state authority: consumer financial protection.

Based on a seminal article by Professor Oren Bar-Gill and then-Professor Elizabeth Warren,[306] Congress included provisions in Dodd-Frank that created the CFPB.[307] The CFPB's mandate is to "regulate the offering and provision of consumer financial products or services" across the United States.[308] To achieve this goal, Dodd-Frank vested the CFPB with the power to police "unfair, deceptive, or abusive acts or practices" in consumer financial transactions,[309] through both rulemaking and enforcement actions.[310] Critics decried this authority, noting that unlike unfair or deceptive acts, which had established meanings in federal law, the concept of an abusive act was novel and overbroad.[311]

Unlike other federal financial regulators, the CFPB's jurisdiction is activities-based.[312] Indeed, the CFPB's authority extends to any entity that "engages in offering or providing a consumer financial product or service."[313] Businesses as disparate as pawn shops, major financial institutions, and fintech firms fall within the CFPB's statutory scope.[314] With this jurisdictional peculiarity, Dodd-Frank reimagined the federal government's role in financial regulation.

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[306] Bar-Gill & Warren, *supra* note 29.
[307] 12 U.S.C. § 5491(a) (2018).
[308] *Id.*
[309] *Id.* § 5531(a).
[310] *Id.* §§ 5512 (authorizing rulemaking), 5514(c) (authorizing enforcement).
[311] *See* Adam J. Levitin, *The Consumer Financial Protection Bureau: An Introduction*, 32 REV. BANKING & FIN. L. 321, 337 (2012) (noting this criticism).
[312] Kress, McCoy & Schwarcz, *supra* note 206, at 1459 ("[The] CFPB is, in many ways, focused on the activities of consumer credit and payment systems, rather than the firms engaging in those activities."); Restoy, *supra* note 241, at 13.
[313] 12 U.S.C. § 5481(6)(A).
[314] *See* Michael B. Mierzewski et al., *The Dodd-Frank Act Establishes the Bureau of Consumer Financial Protection as the Primary Regulatory of Consumer Financial Products and Services*, 127 BANKING L.J. 722, 726 (2010).

Many in the financial community argued that the creation of the CFPB amounted to an unwarranted usurpation of state authority.[315] Though Congress had previously enacted several consumer protection statutes predicated on activities, such as the Truth in Lending Act,[316] responsibility for enforcing these statutes was dispersed across a multitude of regulators, such that these statutes effectively lay dormant for decades.[317] By consolidating prior statutes and complementing them with new protections, Dodd-Frank effected an unprecedented federalization of consumer financial protection, an area of law that the prevailing approach had overwhelmingly left to the states.[318]

With a broad mandate and activities-based jurisdiction, the CFPB entered the fray of fintech regulation. The Bureau issues no-action letters to provide fintech firms with guidance on their legal obligations.[319] It also conducts enforcement actions against fintech firms that engage in predatory practices.[320]

Additionally, the CFPB has provided a much-needed backstop against regulatory arbitrage. In recent years, the CFPB has challenged fintech firms' partnerships with banks and tribes in court, arguing that their attempts to circumvent usury and other state consumer protections violate Dodd-Frank.[321] Policing rent-a-bank arrangements through federal

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[315] *E.g.*, Diane Katz, *Title X and the Consumer Financial Protection Bureau: Limiting Americans' Credit Choices*, THE CASE AGAINST DODD-FRANK: HOW "CONSUMER PROTECTION" LAW ENDANGERS AMERICANS 157, 159 (Norbert J. Michel ed., 2016) ("Federalizing nonbank regulation eliminates regulatory competition which, in turn, undermines market competition.").

[316] *See* Diane Katz & Norbert J. Michel, *Consumer Protection Predates the Consumer Financial Protection Bureau*, HERITAGE FOUND. 5 (May 11, 2017), https://www.heritage.org/sites/default/files/2017-05/BG3214.pdf.

[317] *See* Elosta, *supra* note 134, at 1289; Totten, *supra* note 135, at 126.

[318] *See* Mark E. Budnitz, *The Federalization and Privatization of Public Consumer Protection Law in the United States: Their Effect on Litigation and Enforcement*, 24 GA. ST. U. L. REV. 663, 665 (2012); Catherine M. Sharkey, *Agency Coordination in Consumer Protection*, 2013 U. CHI. LEGAL F. 329, 329 (discussing the "federalization of consumer protection").

[319] *E.g.*, CFPB, Upstart Network, Inc. No Action Letter 2 (Nov. 30, 2020), https://files.consumerfinance.gov/f/documents/cfpb_upstart-network-inc_no-action-letter_2020-11.pdf.

[320] *E.g.*, CFPB, Greensky, LLC Consent Order (July 12, 2021), https://files.consumerfinance.gov/f/documents/cfpb_greensky-llc_consent-order_2021-07.pdf.

[321] *E.g.*, *CFPB Sues CashCall for Illegal Online Loan Servicing*, CONSUMER FIN. PROTECTION BUREAU (Dec. 16, 2013) ("[B]eginning in late 2009, CashCall and WS Funding entered into an arrangement with Western Sky

enforcement is a commendable development, because it reduces the rents that states and tribes can earn from eschewing inter-jurisdictional cooperation and externalizing costs on consumers across the country.[322] Simply put, the CFPB's enforcement strategy provides a federal solution to a state collective action problem.

Although the creation of the CFPB entailed a transformative expansion of federal authority in financial regulation, Dodd-Frank maintained a robust role for states by embracing dynamic federalism.[323] Models of dynamic federalism describe how the federal government sets national standards that state governments then develop and implement within their borders.[324] The federal government thereby delegates a certain degree of policymaking to the states.[325] State enforcement of federal law has an established pedigree,[326] as the Judiciary Act of 1789 authorized state officials to arrest individuals suspected of federal crimes.[327]

Dodd-Frank empowered state law enforcement agencies to file civil actions against entities that violate its statutory provisions or implementing regulations.[328] State governments can therefore serve as norm entrepreneurs, crafting novel litigation theories and developing a body of precedents to establish the

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Financial, a South Dakota-based online lender. Western Sky Financial asserted state laws did not apply to its business because it was based on an Indian reservation and owned by a member of the Cheyenne River Sioux Tribe."), https://www.consumerfinance.gov/about-us/newsroom/cfpb-sues-cashcall-for-illegal-online-loan-servicing/; *see also* Verret, *supra* note 109, at 29 (criticizing this case, arguing "the CFPB essentially federalized a state usury law claim by turning it into a UDAAP violation").

322 *See supra* notes 273-274 and accompanying text.

323 Elosta, *supra* note 134, at 1275.

324 *See id.* at 1296.

325 *See* Harold J. Krent, *Fragmenting the Unitary Executive: Congressional Delegations of Administrative Authority Outside the Federal Government*, 85 NW. U. L. REV. 62, 80 (1990).

326 Joshua D. Sarnoff, *Cooperative Federalism, the Delegation of Federal Power, and the Constitution*, 39 ARIZ. L. REV. 205, 205 (1997) ("Historically, Congress has relied on states to implement the goals and controls of federal policy.").

327 Krent, *supra* note 325, at 81 n.57. For an empirical study of modern federal-state enforcement delegations, see Amy Widman & Prentiss Cox, *State Attorneys General's Use of Concurrent Public Enforcement Authority in Federal Consumer Protection Laws*, 33 CARDOZO L. REV. 53 (2011).

328 12 U.S.C. § 5552(a) (2018).

metes and bounds of Dodd-Frank's prohibition on unfair, deceptive, and abusive acts and practices.[329]

States have heeded Dodd-Frank's call.[330] For example, California recently enacted a "mini-CFPB" statute that consolidated its consumer financial protection statutes under a single agency charged with "exercis[ing] nonexclusive oversight and enforcement authority . . . to the extent permissible, under federal consumer financial laws."[331] Pennsylvania, New Jersey, and Maryland have similarly established or restructured their consumer financial protection agencies to accommodate Dodd-Frank's delegated enforcement regime.[332]

Dodd-Frank's dynamic federalism has grown in importance due to the sharp ideological swings within the federal executive in the past five years. During the Trump administration, the CFPB significantly reduced its enforcement efforts,[333] leading the CFPB's former director to exhort state governments to file suits under Dodd-Frank to fill the void.[334] Presidential ideology is also more likely to guide policy at the CFPB since the Supreme Court declared that the Bureau's Director must be removable at will.[335] But if a future CFPB Director takes a narrower view of the agency's mandate, the states now

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[329] *See* Totten, *supra* note 135, at 126.
[330] *See* Seth Frotman, *Reimagining State Banking Regulators: How the Principles Underlying the Consumer Financial Protection Bureau Can Serve as a Blueprint for a New Regulatory Federalism*, 72 ME. L. REV. 241, 267 (2020).
[331] CAL. FIN. CODE § 90006(a) (2021); *see* Susan Manship Seaman, *A Development to Watch: California's "Mini-CFPB" and Small Business Financing*, BUS. L. TODAY (Nov. 2, 2020), https://www.americanbar.org/groups/business_law/publications/blt/2020/11/ca-mini-cfpb/.
[332] *See* Allyson Baker et al., *Mini-CFPBs: What Increased Regulation, Enforcement, and Supervision by State Agencies Mean for the Financial Services Industry*, VENABLE LLP 2 (Apr. 2020), https://www.venable.com/-/media/files/events/2020/04/mini-cfpb-webinar-slides.pdf.
[333] *See* Robert Schmidt & Jesse Hamilton, *Wall Street Frets Over a Revived CFPB Trump Left Toothless*, BLOOMBERG (Dec. 8, 2020), https://www.bloomberg.com/news/articles/2020-12-08/wall-street-frets-over-a-revival-of-cfpb-left-toothless-by-trump.
[334] Richard Cordray, *The Future of Consumer Protection: Remarks at Loyola University Chicago School of Law*, 31 LOY. CONSUMER L. REV. 411, 415 (2019) (calling on state governments "to carry forward the banner of consumer financial protection, even in conflict with the contrary views of their federal counterparts").
[335] Seila Law LLC v. CFPB, 140 S. Ct. 2183, 2192 (2020).

possess the legal and bureaucratic infrastructure to ramp up enforcement efforts.[336]

Despite its many achievements, Dodd-Frank's federalization of consumer protection law was not plenary. Congress left state consumer protection statutes intact and instead positioned federal law as a floor below which states could not sink.[337] Imposing a minimal standard of federal consumer protection was an appropriate response to state collective action problems, but allowing states to exceed Dodd-Frank's protections preserved the patchwork of activities-based state statutes that defined the prior paradigm and bedevil fintech startups.[338] Congress also refused to federalize the most fundamental area of consumer protection law: usury.[339] Indeed, Dodd-Frank specifically prohibits the CFPB from adopting a national usury limit.[340] Congress therefore balked at replacing one of the most arcane and expensive areas of state law with which fintech firms must comply.[341] Interest rate exportation and rent-a-bank schemes—two of the prevailing paradigm's grossest excesses—therefore survived Dodd-Frank.

Dodd-Frank's federalization of consumer protection nevertheless constituted a watershed moment in the development of a new paradigm of federal-state relations in financial regulation. By focusing the CFPB on financial activities, Congress departed from the entity-based regime that too often overlooked the services performed by non-banks like fintech firms. With an emphasis on substance over form, Dodd-Frank cast a wider net than prior financial initiatives, preventing smaller firms that defied easy categorization from slipping through the cracks of

[336] *See* Cordray, *supra* note 334, at 418; Frotman, *supra* note 330, at 269 ("[S]tate consumer bureaus can stand up when the federal government fails.").
[337] 12 U.S.C. § 5551(a)(2) ("[A] statute, regulation, order, or interpretation in effect in any State is not inconsistent with the provisions of this title if the protection that such statute, regulation, order, or interpretation affords to consumers is *greater* than the protection provided under this title." (emphasis added)).
[338] *See supra* Section I.A.
[339] *See* Douglas, *supra* note 44, at 29; Levitin, *supra* note 6, at 340.
[340] 12 U.S.C. § 5517(o) ("No provision of this title shall be construed as conferring authority on the Bureau to establish a usury limit applicable to an extension of credit offered or made by a covered person to a consumer, unless explicitly authorized by law.").
[341] *See supra* notes 71-75 and accompanying text.

a balkanized regulatory regime.[342] Today, due to its regulatory and enforcement powers, the CFPB is the most important federal regulator for fintech firms, surpassing even the influence of the OCC.[343] The Bureau's national guidance to fintech firms is a promising start on the path towards a future in which fintech firms are no longer beleaguered by the prohibitive compliance costs of inconsistent state mandates.

Politically, Dodd-Frank's creation of the CFPB provided a welcome new role for states. First, federalizing the externality-heavy area of consumer protection helps resolve the prisoner's dilemma among the states by reducing the need for cooperation and benefits of defection. Additionally, nationalizing consumer protection rules ensures that the residents of small states have more of a voice in fintech regulation, since the federal government is more responsive to small state interests[344] and less vulnerable to spillovers from large states like New York. Finally, Dodd-Frank utilized a dynamic federalism framework to harness the resources and creativity of state governments, even in the face of federal intransigence.

3. Safety and Soundness

For all the contestation surrounding the OCC's fintech chartering program, one of the initiative's most remarkable aspects went almost entirely unnoticed—its unprecedented expansion of federal safety-and-soundness oversight into fintech.[345] In the white paper detailing the chartering program, the OCC explained that chartered fintech firms would fall under the OCC's prudential supervision.[346] Although the OCC

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[342] *Cf.* Omarova, *supra* note 14, at 33 (observing that fintech firms rarely fall into the traditional categories of financial regulation).

[343] *Cf.* 2 CONSUMER FIN. PROTECTION BUREAU, TASKFORCE ON FEDERAL CONSUMER FINANCIAL LAW REPORT 81-82 (Jan. 2021) ("The Dodd-Frank Act created in the Bureau a unique agency well-situated to regulate . . . FinTech companies."), https://files.consumerfinance.gov/f/documents/cfpb_taskforce-federal-consumer-financial-law_report-volume-2_2021-01.pdf.

[344] *See* Herbert Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 COLUM. L. REV. 543, 546 (1954).

[345] For the most detailed discussion of this aspect to date, see Menand & Ricks, *supra* note 116, at 7 (remarking in passing that "it is possible the OCC's approach would improve prudential regulation").

[346] OFFICE OF THE COMPTROLLER OF THE CURRENCY, *supra* note 180, at 1 ("[I]f we decide to grant a national charter to a particular fintech company,

has overseen the safety and soundness of national banks since the passage of the NBA in 1864,[347] developing a framework to fit the diverse needs of fintech firms posed a novel challenge.

As recommended by international experts,[348] the OCC proposed an individualized approach: "The scope of supervision activities will follow a risk-based approach commensurate with the size and complexity of the institution, focusing on any elevated risks and unique supervisory challenges presented by a given [chartered firm]."[349] While the OCC's approach remains understandably vague in light of the variety and dynamism of fintech firms' risk profiles, experts believe applicable capital requirements should be modest.[350]

The OCC's willingness to federalize fintech safety-and-soundness supervision is pathbreaking, since non-bank microprudential regulation has long been an area of exclusive state authority.[351] Accordingly, though the OCC's fintech charter initiative as a whole repeated the errors of the prevailing, entity-based approach, the OCC's extension of prudential oversight to fintech firms marks a compelling step towards regulating firms that engage in financial activities generally. Buried within the conventional framework, the OCC included the seeds of a

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that institution will be held to the same high standards of safety and soundness . . . that all federally chartered institutions must meet.").

[347] Tabor et al., *supra* note 50, at 7.

[348] DEPOSITORY TRUST & CLEARING CORP., FINTECH AND FINANCIAL STABILITY: EXPLORING HOW TECHNOLOGICAL INNOVATIONS COULD IMPACT THE SAFETY & SECURITY OF GLOBAL MARKETS 2-3 (Oct. 2017) (explaining how fintech safety and soundness should proceed on a "case-by-case basis" based on "factors, including concentration and interconnectedness risk, fragmentation and substitutability of services and automated decision-making processes"), https://www.dtcc.com/-/media/Files/PDFs/Fintech-and-Financial-Stability.pdf.

[349] OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S LICENSING MANUAL SUPPLEMENT: CONSIDERING CHARTER APPLICATIONS FROM FINANCIAL TECHNOLOGY COMPANIES 14 (July 2018), https://www.occ.gov/publications-and-resources/publications/comptrollers-licensing-manual/files/pub-considering-charter-apps-from-fin-tech-co.pdf.

[350] *See, e.g.*, Vincent Di Lorenzo, *Fintech Lending: A Study of Expectations Versus Market Outcomes*, 38 REV. BANKING & FIN. L. 725, 763 (2019) ("The market outcomes to date on default and delinquency suggest a low level of risk from fintech lending, indicating that there is no need for significantly greater capital requirements.").

[351] *See supra* notes 78-82 and accompanying text.

fundamental shift in the parameters of federal prudential regulation.

Shifting the safety-and-soundness oversight of fintech firms to the federal level is sensible on several fronts. First, the OCC's national scope gives it a high-level view of the entire U.S. financial services industry. This wider field of vision and central vantage point make the OCC an ideal nerve center for a field as evolving and uncertain as fintech prudential regulation. Without the same data, state and tribal officials must operate with less of the information necessary to strike a proper balance between capital reserves and leverage.[352]

Second, the OCC has developed sophisticated tools for assessing safety and soundness that it can deploy in this new arena.[353] By contrast, state governments have overwhelmingly resorted to the brute force tactic of bond-posting requirements to ensure fintech firms possess adequate capital reserves.[354] Presently, states set these bond amounts separately, without any centralized decision-making. Fintech firms therefore must dedicate prohibitive amounts of their capital to posting bonds in order to operate.[355] The cumulative impact of states' scattershot safety-and-soundness rules is an often-insurmountable barrier to entry in financial services and an undue drain on American innovation.

Third, establishing prudential requirements at the federal level prevents state officials from externalizing the risks of fintech firms' failures onto the rest of the country. Safety-and-soundness rules are rife with spillovers, since a jurisdiction can scale back these rules to attract chartering fees, knowing that it will not bear the full costs of the firm's insolvency.[356] For

[352] *Cf.* Kevin J. Stiroh, Executive Vice Pres., Fed. Res. Bank of N.Y., Keynote Remarks at Columbia University's School of International and Public Affairs: A Perspective on Supervisory Objectives and Trade-Offs (Feb. 23, 2017) (recognizing the tension between "ensuring the safety and soundness of financial institutions and promoting efficient financial intermediation that supports the growth and stability of the U.S. economy"), https://www.newyorkfed.org/newsevents/speeches/2017/sti170223.
[353] *See* Calomiris, *supra* note 3, at 396.
[354] *See supra* notes 79-80 and accompanying text.
[355] Hughes, *supra* note 11, at 52; Lo, *supra* note 14, at 132.
[356] *See* Bebchuk, *supra* note 28, at 1448; *see also* Adam J. Levitin, *The Politics of Financial Regulation and the Regulation of Financial Politics: A Review Essay*, 127 HARV. L. REV. 1991, 2043 (2014) ("[P]rudential bank

example, Iceland's laxity in safety-and-soundness transformed the island into one of the EU's financial hubs, but the British and Dutch customers of Icelandic firms suffered most when those firms failed during the 2008 crisis.[357] Thus, federal intervention is a sensible response to the collective action problem posed by state officials' ability to externalize prudential risk.

Finally, federal prudential oversight avoids the legitimacy issues inherent in a state-by-state approach to safety and soundness. As evident in New York's BitLicense program, large states can unilaterally establish a prudential framework for fintech that smaller states must either emulate or recognize,[358] leaving small state residents with a Hobson's choice. Elevating prudential policy questions to the federal level ensures that national standards reflect popular priorities, rather than just the preferences of powerful states.

Given that fintech firms have not yet enrolled in the OCC's chartering program, the OCC is yet to deploy the safety-and-soundness techniques it has developed. Yet the OCC's effort to expand the ambit of federal prudential oversight represents a desirable shift from the duplicative and crude mandates currently imposed by states. Considering the informational, economic, and political advantages of the OCC's proposal, this widely overlooked feature of the fintech chartering initiative may well be one of its most important legacies—a rejection of the prevailing division of federal-state authority in fintech prudential regulation.

4. Systemic Risk

Although created by legislation aimed at curbing the too-big-to-fail problems of SIFIs, FSOC has undergone a stark transformation in the past five years. The Council is increasingly focused on systemically risky *activities*, instead of just large, systemically risky *entities*.[359] This new perspective has enabled FSOC to grapple with the macroprudential implications

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regulators are under pressure to cater to their regulated institutions' interests because of the ability of banks to shop their charter.").

[357] Pierre-Hugues Verdier, *Mutual Recognition in International Finance*, 52 HARV. INT'L L.J. 55, 79 (2011) ("When the Icelandic banks failed in 2008, the claims of British and Dutch depositors exceeded by several orders of magnitude the Icelandic insurance fund's reserves.").

[358] For a discussion of smaller states' responses to the BitLicense initiative, see Section II.A.2.

[359] *See* Kress, McCoy & Schwarcz, *supra* note 206, at 1461, 1478.

of a fragmented, fintech-driven financial sector. By breaking with the traditional, entity-based approach that dominated FSOC's early years, the Council has embraced an activities-based framework that is better equipped to address the economic realities of disaggregation and disintermediation.

Following a period of vigorous SIFI designation and ensuing legal battles,[360] FSOC began to change course during the Trump administration.[361] The business community had long criticized FSOC, arguing SIFI oversight was burdensome to the point of punishing designated firms.[362] Receptive to these concerns, Treasury Secretary Mnuchin called on FSOC to replace the Council's former readiness to designate SIFIs with a three-step process: (1) review macroprudential risks from financial activities; (2) propose activity-specific regulations to address those risks; and, only if those regulations prove inadequate, (3) consider designating SIFIs.[363] FSOC adopted Secretary Mnuchin's framework in formal guidance that expressly endorsed an "activities-based approach" to systemic risk.[364]

Retreating from its entity-based designation authority, FSOC took up its second statutory power: to issue nonbinding recommendations to other federal regulators on how to curb systemic risk.[365] Several scholars argued this strategic change weakened an essential safeguard of Dodd-Frank.[366] However,

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[360] *See supra* notes 206-209 and accompanying text.

[361] *See* John Crawford, *Lessons Unlearned?: Regulatory Reform and Financial Stability in the Trump Administration*, 117 COLUM. L. REV. ONLINE 127, 127 (2017); Lee Reiners, *Rolling Back Dodd-Frank: One Bite at a Time*, DUKE FINREG BLOG (Mar. 11, 2020), https://sites.law.duke.edu/thefinregblog/2020/03/11/rolling-back-dodd-frank-one-bite-at-a-time/.

[362] *See, e.g.*, Sam Kerr, *Despite Losing SIFI Designation AIG Is Still "Too Big to Fail"*, GLOBALCAPITAL (Oct. 3, 2017) (opining "AIG's inclusion on the list of systemically important non-bank financial institutions . . . always felt like a punishment for its role in the crisis"), https://www.globalcapital.com/securitization/article/28mtavz042hpzwadop7uo/equity/despite-losing-sifi-designation-aig-is-still-too-big-to-fail. Indeed, a seminal law review article described the SIFI-designation power as "regulation by threat." Schwarcz & Zaring, *supra* note 207, at 1813.

[363] U.S. DEP'T OF TREASURY, FINANCIAL STABILITY OVERSIGHT COUNCIL DESIGNATIONS 10 (Nov. 17, 2017), https://www.treasury.gov/press-center/press-releases/documents/pm-fsoc-designations-memo-11-17.pdf.

[364] Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 Fed. Reg. 71740, 71744 (Dec. 30, 2019).

[365] 12 U.S.C. § 5322(a)(2)(K) (2018).

[366] *E.g.,* Kress, McCoy & Schwarcz, *supra* note 206, at 1462.

the official distaste for SIFI designations comported with academic critiques of FSOC's entity-based approach as too binary to capture the diverse spectrum of systemic risks in the financial sector.[367]

Less preoccupied with SIFIs, FSOC undertook a broader investigation of which activities introduced macroprudential fragility into the U.S. economy.[368] FSOC's newfound interest in smaller firms enabled it to recognize the emergent risks from fintech. In 2017, the Council hosted a conference at the University of Michigan Law School on "balancing the benefits of FinTech against its potential risks."[369] These discussions eventually crystalized into FSOC's official statement that fintech's disaggregating and disintermediating effects created the potential for cascading failures:

> Financial firms' rapid adoption of fintech innovations in recent years may increase operational risks associated with financial institutions' use of third-party service providers; if critical services are outsourced, operational failures or faults at a key service provider could disrupt the activities of multiple financial institutions or financial markets.[370]

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367 *E.g.*, Skinner, *supra* note 211, at 1417 ("Accounting for those costs underscores the fundamental problem with a binary design: a binary tool can lead to inaccurate results. A more discerning tool, meanwhile, could enable more tailored regulatory interventions, in turn reducing the industry's resistance to the SIFI label.").

368 *See* Annette Nazareth, Margaret Tahyar & Randy Guynn, *Davis Polk Discusses FSOC's Shift to an Activities-Based Approach*, CLS BLUE SKY BLOG (Jan. 22, 2020), https://clsbluesky.law.columbia.edu/2020/01/22/davis-polk-discusses-fsocs-shift-to-an-activities-based-approach/.

369 *FinTech Risks and Opportunity: An Interdisciplinary Approach*, OFF. FIN. RES. (Oct. 3, 2017), https://www.financialresearch.gov/conferences/2017/10/03/fintech-risks-and-opportunities/.

370 FIN. STABILITY OVERSIGHT COUNCIL, 2020 ANNUAL REPORT 183 (2020), https://home.treasury.gov/system/files/261/FSOC2020AnnualReport.pdf.

FSOC therefore committed itself to monitoring the macroprudential implications of fintech and issuing recommendations as necessary.[371]

These efforts have continued under the Biden administration. In its most recent annual report, FSOC reaffirmed its commitment to "to identify and address potential risks to U.S. financial stability using an activities-based approach."[372] The Council also reiterated its concern that the proliferation of specialized fintech firms has introduced counterparty[373] and cybersecurity[374] risks into the economy. Other U.S. financial regulators have celebrated these forays into fintech and encouraged the Council to take further action.[375]

Yet FSOC's focus on fintech activities faces a major hurdle. Because the Council's recommendation power is purely precatory, it must rely on a primary regulator to enact its proposed reforms.[376] However, there is no federal regulator

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[371] *See id.*

[372] FIN. STABILITY OVERSIGHT COUNCIL, 2021 ANNUAL REPORT 140 (2021), https://home.treasury.gov/system/files/261/FSOC2021AnnualReport.pdf.

[373] *Id.* at 125 ("[As] some service providers become more specialized, concentration risk may increase. This is of particular concern where many institutions rely on the same third-party provider for key services and may introduce hidden concentration risk into the supply chain.").

[374] *Id.* at 169 ("[T]echnologies can increase cybersecurity vulnerabilities, insider risks, and other operational exposures. Firms have increased their reliance on third-party service providers to implement these strategies.").

[375] For example, an interagency report on stablecoins, cryptocurrencies pegged to currencies or other reference assets, "recommend[ed] that the Financial Stability Oversight Council consider steps available to it to address the risks" of a run on a stablecoin destabilizing the broader financial system. PRESIDENT'S WORKING GRP. ON FIN. MKTS., REPORT ON STABLECOINS 3 (Nov. 2021), https://home.treasury.gov/system/files/136/StableCoinReport_Nov1_508.pdf. In the words of the current chairman of the Commodity Futures Trading Commission, "FSOC is perfectly suited to address the promise and risks posed by fintech." Rostin Behnam, Comm'r, Commodity Futures Trading Comm'n, Remarks at the International Futures Industry Annual Conference: Accountability and Moving Forward (Mar. 15, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam4.

[376] Hilary J. Allen, *Putting the "Financial Stability" in Financial Stability Oversight Council*, 76 OHIO ST. L.J. 1087, 1116 (2015) ("The legislative debates regarding Dodd-Frank make it clear that legislators deliberately chose not to give the FSOC a direct power to compel action from any agencies . . . .").

directly responsible for policing fintech firms' systemically risky activities.[377] Thus, while FSOC is currently in the information-gathering stage, without legal reform it will inevitably remain there, leaving macroprudential regulation for fintech in a holding pattern.

FSOC's pivot from an entity-based approach predicated on SIFI designations to an activities-based framework constitutes a meaningful departure from the prevailing paradigm of federal financial regulation. This expansion of federal oversight beyond large shadow banks to relatively small fintech firms filled a regulatory void, since state laws solely target the microprudential stability of fintech companies, not their potential threats to the economy as a whole.[378] With its widened perspective, FSOC is now positioned to investigate the nature and severity of fintech firms' counterparty and cybersecurity vulnerabilities.[379] Understanding these threats is not sufficient to restrain them, but it is necessary to do so. FSOC's activities-based framework therefore marks a positive development in the search for a systemic risk framework that grasps the technological realities of today's financial sector.

Despite Dodd-Frank's statutory limitations on FSOC's coercive powers, the Council is forging a new path by embracing a more robust federal regulatory role that eschews the narrow entity-based categories of the prior regime.

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A grand reversal of state and federal regulatory roles is the essence of the New Fintech Federalism. Although the states have long deployed an activities-based approach to consumer financial protection and macroprudential risk, the federal government is increasingly assuming those functions in a manner that reduces arbitrage, resolves collective action problems, and

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[377] *See* Kress, McCoy & Schwarcz, *supra* note 206, at 1510.

[378] *See* XAVIER FREIXAS ET AL., SYSTEMIC RISK, CRISES, AND MACROPRUDENTIAL REGULATION (2015) (observing that micro- and macroprudential regulation are complements, not substitutes); *The Causes of Systemic Risk—and Ways to Prevent Them*, WHARTON (June 30, 2016) (same), https://knowledge.wharton.upenn.edu/article/causes-systemic-risk-ways-prevent/.

[379] *See supra* notes 218-220 and accompanying text.

promotes democratic deliberation.[380] Meanwhile, several state initiatives have pursued an entity-based regime that resembles the chartering approach of federal banking regulators, but confers the benefits of jurisdictional competition in governance matters.[381]

These reforms—some codified, others inchoate—illuminate the path towards a financial sector that is fairer, safer, and more innovative. Instead of discarding the distinctive federalist structure of the U.S. system, the New Fintech Federalism carefully calibrates federal and state roles to maximize the relative benefits of decentralization and supremacy.

But proponents of the prevailing paradigm have proven determined to invoke familiar methods (with familiar costs) when regulating the novel phenomenon of fintech.[382] Overcoming the ballast of policy inertia is no easy task, which is why the achievements of the New Fintech Federalism so far are worth celebrating. Yet these initiatives also warrant a legislative solution that protects and promotes their cumulative benefits. Thus, despite the progress of the past decade, the great work begins.

III. Hastening the Transformation Through Legislation

Disparate acts of state and federal officials have charted a new direction for financial federalism, one fit for the economic exigencies of the twenty-first century. Congressional intervention would shore up these achievements and protect them from faltering against an entrenched status quo. This Part therefore offers a comprehensive legislative solution to codify and improve upon the gains of the New Fintech Federalism by encouraging an entity-based approach defined by competitive federalism at the state level and adopting an activities-based regime for consumer protection and prudential oversight at the federal level.

In four core areas of fintech law—chartering, consumer protection, safety and soundness, and systemic risk—this Article's proposed bill, the Financial Technology Modernization Act (FTMA) would foster responsible innovation, bolstering

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[380] *See supra* Section II.B.
[381] *See supra* Section II.A.
[382] *See supra* Part I.

America's global competitiveness and regulatory safeguards alike.

The FTMA differs from prior proposals that advocate for either state experimentation[383] or federal uniformity[384] at the other's expense. Instead of mutually exclusive substitutes,[385] this Article views state and federal law as potentially harmonious complements. Jettisoning the federalist structure that distinguishes U.S. financial regulation is neither desirable nor likely.

Less satisfactory still, other commentators have championed a "wait and see strategy" of halting regulatory interventions until officials fully understand fintech's impact on the financial sector.[386] While regulators should undoubtedly gather sufficient information before implementing any particular intervention,[387] this Article rejects the proposition that fintech remains too unknown to regulate. After all, granting fintech carte blanche would not somehow permit these firms to transcend the fetters of U.S. law. It would simply devolve responsibility

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[383] *E.g.*, Odinet, *supra* note 12, at 1769 ("It may very well be true that, from a business perspective, the duality [of divergent state laws] makes business compliance difficult. Fintech credit firms that lend or materially assist in lending programs across state lines must potentially obtain and maintain licenses in each state where they do business. However, this is part of choosing to do business in the consumer finance marketplace."); Verret, *supra* note 109, at 38 (arguing a straightforward passporting system will not result in race to the bottom because of customer-imposed market discipline).

[384] *E.g.*, Cuttino, *supra* note 47, at 1575 ("Uniformity in regulation does not have to sacrifice experimentation. Federal-level frameworks can facilitate experimentation, including, for example, through regulatory sandboxes.").

[385] *See* Knight, *supra* note 24, at 206 (advocating a strictly bifurcated approach under which "federal policymakers should consider federalizing fintech regulation and displacing state-by-state rules to an appropriate degree. However, in cases where the transaction is truly intrastate, the federal government should defer to the states"). Given the inherently interjurisdictional nature of the internet, this Article questions the utility of Knight's intrastate/interstate dichotomy for fintech regulation.

[386] Matthew A. Bruckner, *Regulating Fintech Lending*, 37 BANKING & FIN. SERV. POL'Y REP. 1, 4 (2018); *see also* Jeremy Kidd, *Fintech: Antidote to Rent-Seeking?*, 93 CHI.-KENT L. REV. 165, 187 (2018) ("What, then, do we do in the face of a future that many will find distressing? The right answer may be 'nothing.'").

[387] Indeed, regulators *must* consider all important aspects of a problem before acting if they hope to withstand judicial scrutiny under the Administrative Procedure Act and its state analogs. *See* Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

to the courts to work out the proper relationships between fintech firms and their constituencies through the crude instruments of common law suits in tort and contract.[388] A common law approach would only exacerbate the uncertainty and costs of the currently incoherent patchwork of state laws.

To respond to the challenges of the fintech era, Congress should draw on the full array of regulatory resources at its disposal—harnessing the relative strengths of the state and federal governments—by enacting the FTMA.

A. Codifying State Chartering

To reduce the onerous compliance costs on fintech firms operating across jurisdictions, state governments have both collectively and unilaterally moved towards an entity-based regime of reciprocal recognition.[389] But cooperation initiatives result in collective action problems, since states retain incentives to defect and cut restrictions in spillover-intensive areas.[390] This trust problem may well prove insuperable.[391] Accordingly, officials and academics have instead advocated for a passporting regime.[392]

The jurisdictional competition that necessarily accompanies any reciprocal chartering framework would function well for issues less prone to externalities, such as fintech governance.[393] Regulators would also compete over their business expertise and the quality of their infrastructure.[394] Federal intervention to overcome state collective action problems and promote salutary jurisdictional competition therefore appears desirable.

But proponents of federally imposed passporting[395] have thus far failed to appreciate that strategy's greatest legal impediment: the anti-commandeering doctrine. Invoking structural principles of federalism located in the Tenth Amendment,

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[388] *Cf.* Totten, *supra* note 135, at 119 (noting the common law was the sole vehicle for consumer financial protection suits prior to legislation).
[389] *See supra* Section II.A.
[390] *See supra* notes 273-274 and accompanying text.
[391] *See* Brita & Castillo, *supra* note 268, at 54; Luther, *supra* note 58, at 1038; Lo, *supra* note 14, at 119.
[392] *See supra* Section II.A.3.
[393] *See supra* note 280 and accompanying text.
[394] Lehmann, *supra* note 269, at 153.
[395] *E.g.*, Verret, *supra* note 109, at 16.

the Supreme Court announced in *New York v. United States* that Congress cannot order state legislatures to take specific actions.[396] The Court's current conservative majority has taken the doctrine to heart, expanding its reach in recent decisions.[397] However, Congress can exert pressure on states to reform their laws. For example, in *South Carolina v. Baker*, the Court upheld a federal statute providing preferential tax treatment for non-bearer state bonds to incentivize states to eliminate bearer bonds.[398] Threading the needle between permissible encouragement and unconstitutional compulsion is the core challenge for any congressionally enacted passporting regime.

To achieve jurisdictional competition for fintech charters, the FTMA would create a centralized digital platform, modelled off the successes of the NMLS,[399] to track the fintech firms enrolled in a national registry. Fintech firms can only enroll in the national registry if they possess a charter from a state or tribe with a qualifying chartering program. This qualification requirement would allow Congress to limit the registry to firms that use technology to perform lending services and payment processing, rather than opening the floodgates to the entire non-banking financial sector. Fintech firms enrolled in the registry would receive nationwide reciprocity as a matter of federal law, since federal law will preempt any licensing, consumer protection, or safety and soundness laws from jurisdictions that did not grant the company's charter. But rather than replacing these regimes entirely with federal rules, the FTMA would incorporate the chartering jurisdiction's governance provisions and project them across the nation using federal preemption.[400]

Federal law already incorporates state rules in a variety of contexts.[401] Congress has done so in statutes like the Federal

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[396] 505 U.S. 144, 166 (1992) ("[E]ven where Congress has the authority under the Constitution to pass laws requiring or prohibiting certain acts, it lacks the power directly to compel the States to require or prohibit those acts.").
[397] *See* Murphy v. NCAA, 138 S. Ct. 1461, 1481 (2018).
[398] 485 U.S. 505, 511 (1988).
[399] *See supra* notes 237-242.
[400] *Cf.* Verret, *supra* note 109, at 16 ("Counter-intuitively, federal preemption will also be required if any kind of competitive state system is to be established in the nascent field of 'fintech' . . . .").
[401] *See generally* Radha A. Pathak, *Incorporated State Law*, 61 CASE W. L. REV. 1 (2011) (surveying this phenomenon); Theresa C. O'Loughlin, Comment, *Adopting State Law as the Federal Rule of Decision: A Proposed Test*, 43 U. CHI. L. REV. 823, 825-26 (1976) ("[S]tate law, even if adopted as the

Tort Claims Act, which adopts "the law of the place where the act or omission occurred."[402] The judiciary is similarly familiar with federally incorporated state law.[403] For example, in diversity cases, federal rules of incorporation govern conflicts between state laws, embracing one jurisdiction's rule and displacing another's.[404] The FTMA's extension of state law is therefore amply grounded in federal precedent.

Under the FTMA, states would have a strong incentive to adopt a qualifying fintech chartering program because jurisdictions that adopt such a rule would receive a competitive advantage in the race for chartering fees. Moreover, enrolled fintech firms will operate nationwide, even in laggard jurisdictions, so failing to establish a qualifying program would not benefit hesitant states.

This approach is free from anti-commandeering concerns. Although the FTMA encourages states to institute a qualifying chartering program, state governments retain the choice of whether or not to participate in the national registry. Just as the tax provisions in *Baker* spurred legal reform by granting a competitive edge to amenable states,[405] the FTMA would exclusively alter state governments' incentives, without resorting to impermissible coercion.

Through its national registry, the FTMA would inaugurate a massive federal-state partnership with several benefits over the current approach. The FTMA would produce a national

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content of the federal rule, does not govern of its own force, but only by virtue of its incorporation as the federal law.").

[402] *Id.* at 17 (quoting 28 U.S.C. § 1346(b)(1) and discussing analogous provisions in the Foreign Sovereign Immunities Act).

[403] *See* Clearfield Tr. Co. v. United States, 318 U.S. 363, 367 (1943) ("In our choice of the applicable federal rule we have occasionally selected state law.").

[404] *See* Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487, 496 (1941) (holding as a matter of federal law that federal courts exercising diversity jurisdictions must apply the choice-of-law rules of the state in which they sit); *see also* Kermit Roosevelt III, *Choice of Law in Federal Courts: From* Erie *and* Klaxon *to CAFA and* Shady Grove, 106 NW. U. L. REV. 1, 21 (2021) ("[O]bviously no one state can have the last word on the question of whose rights will prevail in case of a conflict. State rules of priority are not binding, either on federal courts or the courts of sister states, because whether a right created by one state's law should prevail over a right created by another is not a matter within the authority of any single state.").

[405] *Baker*, 485 U.S. at 509.

market for fintech firms, easing their compliance burden from inconsistent state laws and allowing them to offer products even in smaller states.[406] Freeing up startup capital to focus on product development would promote innovation and competition in the financial sector, ultimately benefitting consumers.[407] Finally, the FTMA's targeted use of federal preemption would preserve the benefits of decentralized deliberation. States and tribes alike could compete for superior legal rules in pressing areas of fintech governance to garner greater fees.

B. Federalizing Usury Law

Although the FTMA would preempt many state consumer protection laws applicable to fintech companies, it would not produce a legal vacuum. Instead, enrolled fintech firms would be subject to a rigorous consumer protection regime of exclusively federal law. The FTMA would therefore complete Dodd-Frank's trajectory by federalizing the final frontier of consumer financial protection—usury.

Dodd-Frank's unprecedented federalization of consumer protection law remains one of the statute's greatest achievements.[408] But Dodd-Frank refused to intervene in the most fundamental of consumer protection laws, namely usury rates. Indeed, Dodd-Frank expressly prohibited the CFPB from imposing a national interest rate cap,[409] even though commentators have ably argued for a federal usury law for decades.[410]

Congress embraced a national interest rate limit on a limited basis in the Military Lending Act of 2006 (MLA).[411] Enacted in response to reports of widespread, predatory payday

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[406] *See* McQuinn, *supra* note 97, at 9 ("National rules minimize transaction costs for businesses, the benefits of which are passed along to users.").
[407] *Cf.* Lo, *supra* note 14, at 135-36 (describing how state non-bank regulation amounts to "a barrier to entry, since only large and successful businesses can afford to apply for licensure in all relevant states").
[408] *See supra* Section II.B.2.
[409] *See* 12 U.S.C. § 5517(o) (2018); *see also supra* notes 339-341 and accompanying text.
[410] *See, e.g.*, Felsenfeld, *supra* note 49, at 495 (describing a federal usury proposal from 1967); Pearl Chin, Note, *Payday Loans: The Case for Federal Legislation*, 2004 U. ILL. L. REV. 723. For more recent examples, see Munger, *supra* note 129, at 495; and Palladino, *supra* note 49, at 103.
[411] 10 U.S.C. § 987 (2018).

loans to active service members of the armed forces,[412] the Act imposed a usury rate of thirty-six percent on loans to active duty service members and their dependents.[413] The MLA also included ancillary protections, such as mandatory oral disclosures[414] and a prohibition on prepayment penalties.[415] But like Dodd-Frank, the MLA's provisions were a floor, not a ceiling, since the Act expressly did not preempt state laws offering greater protection to service members and their dependents.[416]

Proposals to federalize usury law for all Americans have gained traction since the MLA's enactment. Most recently, a group of twelve Democratic Senators introduced a bill to expand the MLA's protections to consumers generally, effectively federalizing usury law.[417] The Department of Defense released a study in 2021 that concluded the MLA's thirty-six percent usury cap reduced predatory loans without significantly impairing service members' access to credit.[418] The MLA is likewise popular within the military, as veterans' groups have vociferously defended it before Congress.[419] Scholars have compelling argued that many members of the general public exhibit the same vulnerabilities as service members.[420] Finally,

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[412] *See* U.S. DEP'T OF DEF., REPORT ON THE MILITARY LENDING ACT AND THE EFFECTS OF HIGH INTEREST RATES ON READINESS 5 (May 2021), https://finred.usalearning.gov/assets/downloads/FINRED-MLA_ReportEffectsHighInterestRatesOnReadiness-May2021.pdf.

[413] 10 U.S.C. § 987(b).

[414] *Id.* § 987(c).

[415] *Id.* § 987(e)(7).

[416] *Id.* § 987(d)(1) ("[T]his section shall not preempt any such law, rule, or regulation that provides protection to a covered member or a dependent of such a member in addition to the protection provided by this section.").

[417] *U.S. Senators Seek to Cap Consumer Loans at 36%*, U.S. SEN. COMM. ON BANKING, HOUSING & URB. AFF'RS (July 28, 2021) ("In addition to [Senators] Reed, Merkley, Brown, and Van Hollen, the bill is also cosponsored by U.S. Senators Tina Smith (D-MN), Cory Booker (D-NJ), Richard Blumenthal (D-CT), Brian Schatz (D-HI), Dianne Feinstein (D-CA), Raphael Warnock (D-GA), Patrick Leahy (D-VT), and Ron Wyden (D-WA)."), https://www.banking.senate.gov/newsroom/majority/us-senators-seek-to-cap-consumer-loans-at-36; Megan Leonhardt, *Senate Democrats Want to Cap Interest Rates on Loans at 36%*, FORTUNE (July 29, 2021), https://fortune.com/2021/07/29/senate-democrats-student-loans-interest-rates/.

[418] U.S. DEP'T OF DEF., *supra* note 412, at 7.

[419] *See* Paul E. Kantwill & Christopher L. Peterson, *American Usury Law and the Military Lending Act*, 31 LOY. CONSUMER L. REV. 500, 503 (2019).

[420] Creola Johnson, *Congress Protected the Troops: Can the New CFPB Protect Civilians from Payday Lending?*, 69 WASH. & LEE L. REV. 649, 666

national surveys have found that federal usury rates poll well among the general population.[421]

The FTMA would therefore extend the MLA's thirty-six percent usury cap and associated protections to any loans offered to consumers in the United States. Implementation of the new federal interest rate limit would fall to the CFPB, which already has ample expertise in consumer finance.[422] Drawing on the CFPB's powers under Dodd-Frank, the FTMA would instruct the CFPB to promulgate and enforce usury regulations.

While the FTMA's other provisions are limited to enrolled fintech firms, its usury rate would be generally applicable. Otherwise, Congress would simply replicate the errors of *Marquette*. Enrolled fintech firms would enjoy a competitive advantage over non-banks in jurisdictions with usury caps below thirty-six percent. Thus, fintech firms would sell their privileges in "rent-a-fintech" partnerships closely resembling current arbitrage schemes.

As a national usury law, the FTMA would preempt state usury laws, in contrast to the permissive approach of Dodd-Frank and the MLA.[423] Thus, the consumer protection laws applicable to enrolled fintech firms would be exclusively federal, as any state licensing or disclosure laws would be preempted. By contrast, while other non-banks would fall under the FTMA's national usury rate, they would still be subject to other state consumer protection laws, including licensing and disclosure statutes.

To ensure a meaningful role for state consumer financial protection, the FTMA would also deploy the dynamic federalism strategy of Dodd-Frank.[424] By authorizing state law enforcement agencies to sue violators of the FTMA's usury cap,

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(2012); Nathalie Martin, *Public Opinion and the Limits of State Law: The Case for a Federal Usury Cap*, 34 N. ILL. U. L. REV. 259, 262 (2014).

421 *See* Munger, *supra* note 129, at 496.

422 *See* Cuttino, *supra* note 47, at 1572 ("Specifically, the CFPB is experienced in developing and ensuring compliance with consumer-protection laws—it was created for that very purpose.").

423 *Cf.* Bar-Gill & Warren, *supra* note 29, at 83 ("In an era of interstate banking, uniform regulation of consumer credit products at the federal level may well be more efficient than a litany of consumer protection rules that vary from state to state.").

424 *See supra* notes 323-329 and accompanying text.

the FTMA would enlist state officials as norm entrepreneurs. Additionally, state usury enforcement would serve as a failsafe should future presidential administrations prove unwilling to police predatory lending.[425]

Subjecting fintech firms to an exclusively federal consumer protection regime and imposing a usury limit of thirty-six percent on all consumer lending activities would eliminate many of the prevailing paradigm's worst vices. For fintech firms and other non-banks alike, the FTMA would replace the polyphonic confusion of the current state-by-state approach to usury with a single, authoritative standard announced by the CFPB.[426] Since every firm would be subject to a uniform usury rate, interest rate exportation would cease to exist. Thus, the FTMA would preclude a jurisdictional race to the bottom for lower interest rate caps, obviating the need for transactions-costly rent-a-bank and rent-a-tribe schemes.[427] The simplicity of a general federal usury law would also avoid the litigation expenses associated with adjudicating *Madden*-style and true lender suits to challenge arbitrage arrangements. Finally, the FTMA would bolster national deliberation at the federal level on how usury laws should be implemented and enforced against fintech firms, ensuring individuals in all states have a meaningful voice.[428]

C. National Safety and Soundness for Fintech

Building off the OCC's safety-and-soundness research for its fintech chartering initiative,[429] the FTMA would require enrolled fintech firms to submit to microprudential oversight by the OCC. Although a bank regulator, the OCC already supervises a range of entities with specialized business models, like

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[425] *See supra* notes 333-336 and accompanying text.
[426] *Cf.* Marvin, *supra* note 72, at 1842 (describing how "platforms' operating costs rise to ensure compliance with every state's anti-usury law, thereby decreasing credit availability").
[427] *See* Munger, *supra* note 129, at 496; Martin, *supra* note 420, at 280 ("A trim federal interest rate cap would eliminate this [rent-a-tribe] loophole, as even tribes are bound by federal law.").
[428] *Cf.* McQuinn, *supra* note 97, at 9 ("[N]ational rules increase efficiency in the policymaking process. When 50 different states make laws on the same topics, stakeholders must engage in the same policy debates in multiple forums.").
[429] *See supra* notes 348-349 and accompanying text.

credit card banks.[430] To do so, the OCC employs sophisticated risk-management techniques tailored to individual firms' balance sheets.[431] Due to its expertise and oversight tools, the OCC is well situated to address the safety-and-soundness needs of fintech firms and strike the proper balance between their capital reserves and operating capacities.

While the legality of the OCC's fintech chartering program remains uncertain,[432] the FTMA would carry the clear imprimatur of Congress. Removing this chilling effect would make fintech firms more enthusiastic about enrolling in the FTMA's national registry. Moreover, the preemption benefits the FTMA offers to enrolled firms would give fintech companies a strong incentive to accept the burdens of OCC supervision.

Federal fintech safety-and-soundness is an attractive alternative to the current microprudential approach among the states. In contrast to the OCC's fine-grained supervisory tools, state governments overwhelmingly regulate non-banks using crude bond-posting requirements.[433] Because these mandates apply territorially, fintech firms operating across multiple jurisdiction must dedicate infeasible amounts of capital to these bonds. The economic and legitimacy costs of the territorial bond-posting regime fall hardest on residents of small states. Since large states often require especially hefty bonds,[434] some fintech firms refuse to serve customers in less profitable jurisdictions.[435] Individuals in overlooked jurisdictions therefore

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[430] *See* OFFICE OF THE COMPTROLLER OF THE CURRENCY, COMPTROLLER'S LICENSING MANUAL: CHARTERS 51 (Oct. 2019) ("Special purpose bank proposals to date include those banks whose operations are limited to certain activities, such as credit card operations, fiduciary activities, community development, or cash management activities."), https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-licensing-manual/files/charters.pdf.

[431] *See, e.g.*, OFFICE OF THE COMPTROLLER OF THE CURRENCY, SAFETY AND SOUNDNESS: MODEL RISK MANAGEMENT 1 (Aug. 2021), https://www.occ.treas.gov/publications-and-resources/publications/comptrollers-handbook/files/model-risk-management/index-model-risk-management.html.

[432] *See supra* 186-190 and accompanying text.

[433] *See supra* notes 79-80 and accompanying text.

[434] *See* Lo, *supra* note 14, at 132 (describing the bond amounts in California, Texas, Florida, New York, and Illinois).

[435] *See* Ctr. for Cap. Markets Competitiveness, *supra* note 25, at 41 ("Holding licenses in more than one state often necessitates replicating this financial commitment in each state. Licensees are also subject to examination in

lose access to superior financial products and the ability to impact microprudential policy through the political process.

On the other hand, enabling founders to opt into a single state's safety-and-soundness rules would merely create new problems. Because prudential oversight is an area rife with spillovers, state governments in a safety-and-soundness passporting regime would maximize their narrow self-interest by slashing capital reserve requirements and externalizing the risk of failure onto other states.[436] Accordingly, the optimal legal regime locates prudential supervision responsibilities in the federal government.

Replacing the current state-by-state regime with OCC oversight would ensure that capital reserve requirements are proportionate with fintech firms' overall risk profiles. The rigors of federal supervision would require greater government expenditures than states' straightforward bond-posting statutes, but the informational advantages of centralized decision-making would reduce the social costs of inefficient and duplicative state rules. Additionally, fintech firms that currently flout state statutes by falling through the cracks of various jurisdictions would have no longer have any excuse to avoid prudential regulation. The FTMA would therefore empower the OCC to reduce the risk of fintech firm failures, avoid the inefficiencies of the currently decentralized approach, and foster greater choice for small-state residents.

D. Addressing Fintech's Systemic Risks

FSOC has already embraced an activities-based approach that is receptive to the growing macroprudential risks posed by fintech fragmentation; however, FSOC's current precatory power to issue recommendations is impotent so long as no federal regulator is authorized to impose systemic risk obligations on fintech firms.[437] To fill this gap in U.S. financial regulation, the FTMA would grant FSOC's Office of Financial Research (OFR) rulemaking, supervisory and enforcement authority over enrolled fintech firms to prevent them from subverting

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each state in which they are licensed. These costs, as well as other features of certain state money transmitter laws, have led some digital asset businesses to avoid certain states.").

[436] *See supra* 356-357 and accompanying text.

[437] *See supra* notes 376-377 and accompanying text.

stability. As FSOC's permanent intelligence unit, the OFR employs economists who are expert in macroprudential analysis.

While the OCC may seem like an attractive systemic risk regulator at first blush given its supervisory experience and key role in the FTMA,[438] micro- and macroprudential considerations are sufficiently distinct to require different tools and warrant separate regulators to avoid the agency costs from a dual mandate.[439] But interagency dialogue in these related areas of prudential risk management is essential, so the FTMA would require the OCC and OFR to notify and confer with each other before initiating any rulemakings pursuant to the FTMA.

Since expert understanding of the systemic risk implications of fintech remains embryonic, FSOC would likely stay its course for the time being, continuing to monitor and investigate the issue before intervening directly.[440] But limiting FSOC to its current research agenda, as some scholars have advocated,[441] would be contrary the very purpose for creating FSOC in Dodd-Frank: to *prevent* future crises, rather than merely analyze them *ex post*.[442] Instead, once the OFR has a working framework for fintech's systemic risks, it should proceed with

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[438] *See* Luther, *supra* note 58, at 1039 ("[The OCC's] fintech chartering should produce broader economic benefits by reducing systemic risks associated with these firms and potentially preventing a future crisis.").

[439] *Cf.* John C Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have a Better Idea?*, 95 VA. L. REV. 707, 724 (2009) (exploring the costs associated with combining consumer protection and safety-and-soundness responsibilities in a single agency, given tradeoffs between these two goals).

[440] *Cf.* Skinner, *supra* note 211, at 1423 ("The fintech field is still evolving, and a rush to regulate quantitatively could stifle valuable innovation and growth. And that cost may not be justifiable against existing uncertainty about whether, if at all, fintech activities do in fact present legitimate systemic risks.").

[441] *See* Hilary J. Allen, *Resurrecting the OFR*, J. CORP. L. (forthcoming 2022) (manuscript at 52), https://ssrn.com/abstract=3727585.

[442] *Cf.* Daniel K. Tarullo, *Financial Regulation: Still Unsettled a Decade After the Crisis*, 33 J. ECON. PERSP. 61, 78 (2019) ("It would be crueler still if Congress and federal financial agencies were to wait for another serious financial dislocation before they turned their attention to new risks from new sources."); Lavinia Franco et al., *Does Fintech Contribute to Systemic Risk? Evidence from the US and Europe* 13 (Asian Dev. Bank Inst. Working Paper No. 1132, 2020) ("[I]t is necessary to consider and develop a regulatory framework now, *before* fintech contributes to risk in the financial system." (emphasis added)), https://www.adb.org/sites/default/files/publication/606506/adbi-wp1132.pdf.

stress tests. Though the first stress tests of enrolled fintech firms would likely be irregular and qualitative,[443] in time the OFR could deploy quantitatively rigorous and enforcement-backed oversight techniques.

Broadening the OFR's mandate would alter FSOC's unusual structure. With enhanced responsibilities, the OFR would require a larger permanent staff, such that FSOC would more closely resemble a traditional agency.[444] Expanding FSOC's powers over enrolled fintech companies would push it further down the path of becoming the kind of general systemic risk regulator that academics argue is necessary to promote economic stability.[445]

The FTMA would enable FSOC's OFR to police systemically risky fintech activities, rather than merely study them. This legislative intervention would be timely, because permitting OFR to develop appropriate risk management tools now would allow FSOC to prevent fintech-driven financial crises in the future. If Congress waits until the macroprudential threat of fintech has already suffused the U.S. financial system to craft a legislative response, the opportunity for preparedness will have already passed.

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By enacting the FTMA, Congress can solidify the gains of the New Fintech Federalism's early achievements. The Act's reforms to state chartering, usury, safety-and-soundness supervision, and systemic risk controls would solve the prevailing paradigm's most egregious shortcomings. As a framework for twenty-first century financial regulation, the FTMA would not reject the distinctly federalist structure of U.S. law, but rather reinvent it for our time.

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[443] *See* Skinner, *supra* note 211, at 1426 ("In the case of emerging or potential systemic activities or institutions, like payments and lending in fintech companies, a substantially qualitative stress test might alone suffice (for now). Such stress tests could gather information about the institution's exposures to institutional counterparties, core technologies, and mix of financial activities.").

[444] *Cf.* Allen, *supra* note 441, at 34-37 (examining OFR's staffing and advocating for higher salaries to compensate its experts' opportunity costs).

[445] *See* Kress, McCoy & Schwarcz, *supra* note 206, at 1519.

Conclusion

New challenges require new solutions. As the ascendency of fintech has transformed the U.S. financials sector, the costs of the current legal landscape for entrepreneurs, consumers, and the economy as a whole have become abundantly clear. But through several policy initiatives, state and federal officials have pioneered a new division of authority between these two levels of government that comports with the interjurisdictional nature of fintech. This New Fintech Federalism promotes interstate competition for governance rules, while federalizing issues that produce spillovers and collective action problems.

This Article traces how the New Fintech Federalism accomplishes these previously elusive goals through its grand reversal of the regulatory strategies of state and federal actors—with an entity-based state governance regime and an activities-based federal approach to consumer protection and prudential oversight. To preserve officials' nascent reforms, this Article offers a comprehensive legislative solution that would create a sprawling federal-state partnership and reshape U.S. financial law in the New Fintech Federalism's image. With a robust role for state and federal governments alike, as well as steadfast commitments to economic vitality and consumer protection, this Article's proposed statute serves as a rebuttal to commentators who treat these ends as mutually exclusive. By passing the FTMA, Congress would show global leadership in the realm of financial regulation, elevating the best initiatives around the country into a national policy bold enough to resolve the fintech industry's most glaring issues.