

February 8, 2019

Mr. Paul Watkins
Assistant Director
Office of Innovation
Bureau of Consumer Financial Protection
1700 G Street NW
Washington, DC 20552

RE: Policy on No-Action Letters and the BCFP Product Sandbox [CFPB-2018-0042]

Dear Assistant Director Watkins,

The Information Technology & Innovation Foundation (ITIF) is pleased to submit these comments in response to the Bureau of Consumer Financial Protection's (BCFP) request for comment (RFC) on its proposed rules for no-action letters and the BCFP product sandbox.¹ No-action letters are letters issued by government agencies, in response to an inquiry, publicly stating that an agency will not bring enforcement actions against a particular product or service. Government agencies can use no-action letters to reduce regulatory risk for companies and signal to the market acceptable behavior. Regulatory sandboxes are sets of rules created by government agencies to allow organizations to test products or services under specific conditions. Government agencies can use regulatory sandboxes to minimize the set of rules emerging products and services must comply with, especially when those products and services do not fit into existing regulatory frameworks or when existing regulations would be inappropriate.

ITIF is a nonprofit, non-partisan public policy think tank committed to articulating and advancing a pro-productivity, pro-innovation and pro-technology public policy agenda internationally, in Washington, and in the states. Through its research, policy proposals, and commentary, ITIF is working to advance and support public policies that boost innovation, e-transformation, and productivity.

¹ Bureau of Consumer Financial Protection, "Policy on No-Action Letters and the BCFP Product Sandbox" *Federal Register*, December 13, 2018, accessed January 23, 2019, <https://www.federalregister.gov/documents/2018/12/13/2018-26873/policy-on-no-action-letters-and-the-bcfp-product-sandbox>.

Since the founding of the BCFP (then called the Consumer Financial Protection Bureau), its primary focus has been on facilitating consumer protection. However, one of the Bureau’s statutory mandates is also to promote innovation in financial services.² While BCFP has a history of experimenting with sandbox regulation—indeed, the Bureau set up its first sandbox-like regulation, Project Catalyst, in 2012—the Bureau has made slow progress towards enabling more financial innovation through a flexible regulatory system. ITIF commends the Bureau’s move to support this important goal by setting up the Office of Innovation and through its recent proposed rulemaking for no-action letters and BCFP product sandbox. Both policy changes, if executed properly, could help the BCFP create a more flexible regulatory framework for innovative financial services that facilitates greater experimentation. Through these mechanisms, firms would no longer be shackled with relying on enforcement discretion and would have increased confidence that they will be in compliance.

ITIF welcomes the opportunity to provide input on how the Bureau can use no-action letters and a regulatory sandbox approach to spur innovation in financial services.

BACKGROUND

Under Dodd-Frank, the BCFP has statutory authority to identify and address outdated, unnecessary, or unduly burdensome regulations to reduce unwarranted regulatory burdens, as well as ensure markets for financial products and services operate transparently and efficiently to facilitate access and innovation.³

BCFP is using this authority to make two policy changes. First, this rulemaking would update a 2016 policy allowing the BCFP to issue no-action letters. Just one company, Upstart Network, received a no-action letter under the currency policy, but different rules might make it useful for more businesses.⁴ The new approach improves on the policy in three ways: 1) by streamlining the application process; 2) by giving the BCFP greater discretion on when it can issue no-action letters; and 3) by enabling the agency to issue no-action

² Section 1021(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), 12 U.S.C. 5511(a), General Powers of the Bureau, https://www.cftc.gov/sites/default/files/idc/groups/public/@swaps/documents/file/hr4173_enrolledbill.pdf.

³ Section 1021(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), 12 U.S.C. 5511(a).

⁴ Christopher D’Angelo, “Response to No-Action Letter by Upstart Network” (Consumer Financial Protection Bureau, September 14, 2017), accessed January 21, 2019, https://files.consumerfinance.gov/f/documents/201709_cfpb_upstart-no-action-letter.pdf.

letters which are valid indefinitely. No-action letters enable BCFP to send a signal to the market about what behavior is permissible, thereby enabling financial services to innovate within those parameters.

Second, it would create a BCFP product sandbox that gives organizations a two-year exemption from complying with certain obligations enforceable under the Dodd Frank Wall Street Reform or any other identified statutory or regulatory authority within the Bureau’s jurisdiction to make it easier to test a product or service. Organizations must apply to participate in the product sandbox and those who are accepted would commit to sharing data with the Bureau. This data would give the BCFP more insight into how fintech products and services work, enabling them to work hand-in-hand with industry to allow for more financial innovations to come to market while still upholding consumer protections.

Moreover, the Bureau may revoke its no-action letter relief or acceptance to its product sandbox if an organization has failed to comply in good faith with the terms and conditions, if the organization has caused material, tangible harm to consumers, or if the legal uncertainty that was the basis for a no-action letter or acceptance into the product sandbox changes due to a statutory change or Supreme Court decision.

BCFP SHOULD USE NO-ACTION LETTERS AND ITS PRODUCT SANDBOX TO FACILITATE EXPERIMENTATION IN FINANCIAL SERVICES

Emerging financial products and services are often halted by regulators because they do not fit neatly into predefined categories within the law. Fintech companies currently face a complex regulatory environment designed for older business models and slow to change, created by the patchwork of federal, state, and local rules for financial services. No other federal regulator of financial services in the United States has the same remit to promote innovation in the sector, and absent substantial action and leadership from the Bureau, some other regulators will apply rules designed for traditional financial services—efforts that could stifle emerging fintech products and services.⁵ It is therefore incumbent on the Bureau to use the updated no-action letters and product sandbox to enable experimentation in the U.S. market for financial services, coordinating its actions with other federal agencies and state regulators.

To help prove the utility of BCFP’s no-action letter and product sandbox and cement these program’s benefits in the minds of other regulators, BCFP should first focus on giving safe harbor to technologies and

⁵ Alan McQuinn, Weining Guo, and Daniel Castro, “Policy Principles for Fintech” (Information Technology and Innovation Foundation, October 2016), <http://www2.itif.org/2016-policy-principles-fintech.pdf>.

services that all sides agree would be beneficial. For example, many observers see fintech services that expand access to credit using a wider range of data from alternative sources, like rent and utility payments, as a potential solution to decreasing the unbanked or underbanked population in the United States.⁶ Indeed, expanding credit to unbanked and underbanked individuals was the focus of BCFP’s first no-action letter for Upstart Network.⁷ The Bureau was right to use this issue as a proving ground and should continue to explore ways for using the updated sandbox and no-action letter authorities to expand access to credit. It should then publish information on the successes and failures of these programs to give the public a better understanding of them.

BCFP has the opportunity to encourage innovation in financial services by using no-action letters to clarify acceptable business practices and accepting innovative businesses to its product sandbox, investigating and mitigating the risks associated with each service. ITIF believes the Bureau’s proposed rules for a product sandbox can effectively mitigate these risks because BCFP will receive the information it needs on each product or service’s potential consumer harms, will have the ability to use data from the product or service to track those potential harms, and if harm should occur, the Bureau can revoke admission to its product sandbox. Regarding no-action letters, the Bureau will not receive a data sharing agreement, and should therefore be vigilant and investigate complaints alleging tangible, consumer harm from recipients of these letters. Without robust monitoring of consumer harms, other regulators may intervene and impede upon the Bureau’s efforts.

BCFP SHOULD FORCEFULLY DEFEND ITS NO-ACTION LETTERS AND PRODUCT SANDBOX POLICY

When regulators attempt to create flexible regulatory models to enable financial innovation, there is often pushback from other regulators that see a potential loss of jurisdiction. For example, when the Office of the Comptroller of the Currency (OCC) created rules for a fintech bank charter, New York’s Department of Financial Services (NYDFS) and the Conference of State Bank Supervisors launched multiple lawsuits to stop the OCC rules from preempting state jurisdiction.⁸ Some state regulators will also likely oppose the BCFP’s rules around no-action letters and regulatory sandboxes. Indeed, Maria Vullo, the superintendent of the

⁶ Daniel Castro and Joshua New, “Comments to the CFPB on Alternative Data” (Center for Data Innovation, May 2017), accessed January 29, 2019, <http://www2.datainnovation.org/2017-cfpb-alternative-data.pdf>.

⁷ D’Angelo, “Response to No-Action Letter by Upstart Network.”

⁸ “CSBS Sues OCC Over Fintech Charter,” Conference of State Bank Supervisors, news release, October 25, 2018, <https://www.csbs.org/csbs-sues-occ-over-fintech-charter>.

NYDFS, has already dismissed regulatory sandboxes, saying “Toddlers play in the sandbox. Adults play by the rules.”⁹ Moreover, federal regulators, such as the Securities Exchange Commission, have voiced skepticism of sandbox approaches.¹⁰

To guarantee its rules around no-action letters and product sandbox are effective and give industry partners confidence in their relief, BCFP should forcefully defend these policies against both state and federal interference. The Dodd Frank Act of 2010 granted the BCFP with authority to exempt financial entities, conditionally or unconditionally, from its provisions.¹¹ Moreover, the BCFP can preempt state laws if they are inconsistent with its provisions.¹² BCFP’s proposal includes consumer disclosure components and an agreement on behalf of the recipient to compensate consumers for material, quantifiable, economic harm caused during the BCFP product sandbox. These components offer significant consumer protections that could be reasonably expected from other laws. Therefore, the Bureau has a strong case for state preemption under Dodd-Frank. Moreover, the BCFP’s flexible approach to regulation will facilitate innovation and competition. Allowing for experimentation in financial services can help lead to that better market for financial services, and as a result, a more protected consumer. State laws that impede these efforts in favor of being overly-punitive towards innovation will cause more harm than good.

BCFP should be ready to defend its proposed rules. This will require robust coordination on both the federal and state level. Under Dodd Frank, state attorneys general have to notify the BCFP when they want to use section 1042 authority to pursue cases against financial entities.¹³ When this occurs, BCFP should intervene and forcefully defend the relief it is promising. Certainly, BCFP cannot stop all challenges. The Bureau does not have authority over all consumer protection laws, and consumers still have private rights of action. However, defending its proposal against some state action will help ensure recipients of no-action letters and the BCFP product sandbox have confidence in the Bureau’s new rules.

⁹ Josiah Wilmoth, “‘Toddlers Play in the Sandbox’: NYDFS Chief Denies Bitlicense Stifles Innovation,” *CCN*, June 7, 2018, accessed January 25, 2019, <https://www.ccn.com/toddlers-play-in-the-sandbox-nydfs-chief-denies-bitlicense-stifles-innovation/>.

¹⁰ “Forget the sandbox, just build a web page - SEC commissioner,” *Finextra*, May 8, 2018, accessed January 25, 2019, <https://www.finextra.com/newsarticle/32073/forget-the-sandbox-just-build-a-web-page---sec-commissioner>.

¹¹ 12 U.S. Code § 5512.

¹² To be sure, state laws that provide “greater protections” are not deemed inconsistent under Dodd Frank.

¹³ 12 U.S. Code §1042.

BCFP Should Clarify How It Intends to Use Data Gathered from the BCFP Regulatory Sandbox

Appropriate disclosure of data will either create an incentive or disincentive for firms to participate in the BCFP regulatory sandbox. The current rulemaking takes a deliberate approach to disclosure of information from no-action letters and during the BCFP product sandbox. First, the BCFP will publish no-action letters, both those it accepts and denies. This disclosure is fundamental to these letters' effectiveness, as they will send signals to the market about what behavior is permissible and what is not. Second, the Bureau will disclose certain information on its website, including the identity of entities admitted, the subject matter scope of their participation, the duration, the type of relief, the legal authority and basis for approval and exemption, and more.¹⁴ Third, the Bureau will follow the Disclosure Rule for confidential information, which generally prohibits sharing under the Freedom of Information Act (FOIA), especially when that sharing includes trade secrets and confidential commercial or financial information that is privileged.¹⁵ This rule covers any information provided to the Bureau by a financial institution to enable the Bureau to monitor for risks to consumers in the offering or provision of consumer financial products or services. Fourth, the Bureau is obligated to share certain information with other federal and state agencies.¹⁶ Finally, the Bureau will make its intent to disclose publicly any non-confidential information known in the terms-and-conditions document signed by sandbox participants.

The policy outlined above treats the disclosure of information gathered through no-action letters and the BCFP product sandbox appropriately. To instill confidence in the BCFP's ability to regulate emerging technologies, the Bureau should air on the side of transparency. First, the Bureau should publish the reasons it accepts or rejects any petition for relief under its no-action letters or admission to its product sandbox. This will send better signals to the market about what behaviors are permissible and enable potential applicants to optimize their petitions. Second, BCFP should publicly disclose any reported risks for each service admitted to its product sandbox to ensure consumers and other businesses properly understand risk, but not disclose any confidential information. Third, the Bureau should work with organizations to resolve complaints directly without bringing enforcement action in cases where inadvertent violations occur with no consumer harm.¹⁷ Fourth, the Bureau should be clear about how it intends to use the data it gathers from the sandbox

¹⁴ Bureau of Consumer Financial Protection, "Policy on No-Action Letters and the BCFP Product Sandbox."

¹⁵ 12 CFR part 1070.

¹⁶ Bureau of Consumer Financial Protection, "Policy on No-Action Letters and the BCFP Product Sandbox."

¹⁷ Daniel Castro and Alan McQuinn, "How and When Regulators should Intervene" (Information Technology and Innovation Foundation, February 2015), <http://www2.itif.org/2015-how-when-regulators-intervene.pdf>.

for other purposes, including whether it will use this information to inform separate enforcement actions not covered by current sandbox relief or as a basis for relief for other firms. Finally, for information that the BCFP wishes to disclose to the public, the Bureau should share this information as open government data in a non-proprietary and machine-readable format. Publishing this information as open data allows third parties to create apps to analyze and visualize that data, improving transparency in the financial regulatory system.¹⁸

CONCLUSION

The financial regulatory system in the United States has held back many innovations that could improve financial inclusion, foster competition, and bring an era of better consumer transparency and choice.¹⁹ The BCFP’s proposed rulemaking to reform no-action letters and create a product sandbox are a welcome change that, if executed properly, could tackle this challenge and encourage a wave of transformative financial innovation.

Sincerely,

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¹⁸ For example, the U.K. Treasury and an industry-led coalition called the Open Banking Working Group published an open-data banking standard to deliver better access to banking data through application program interfaces (APIs). Open Banking Working Group (OBWG), *The Open Data Standard* (OBWG, February 2016), <https://www.scribd.com/doc/298569302/The-Open-BankingStandard>.

¹⁹ McQuinn, Guo, and Castro, “Policy Principles for Fintech.”