

POLICY SPOTLIGHT

Fintech Lending—Regulatory Challenges, Regulatory Solutions

BRIAN KNIGHT | OCTOBER 2018

Thanks to the rise of financial technology, nonbank “fintech” firms have become an important source of credit for individuals and small businesses. These lenders compete on a national scale with banks, often offering services at lower cost and lower risk. They also improve access for underserved populations and in areas that have seen significant decline in the number of banks. However, recent regulatory developments are posing challenges for fintech firms and their ability to expand access to credit for millions of Americans. Nonbank fintech firms are generally subject to inconsistent and onerous state-by-state regulation, even though their transactions are frequently interstate in nature. By contrast, banks are subject to relatively uniform rules because of federal preemption. The unequal treatment of banks and nonbank fintech firms tilts the playing field against the latter.

CONSEQUENCES OF BURDENSOME, STATE-BY-STATE REGULATION

The current regulatory regime for nonbank fintech firms creates three separate but interrelated problems:

- 1. It harms consumers by forcing fintech firms into an environment where costs are often higher than necessary.* Having to obtain licenses from each state in which a nonbank firm wishes to do business can be costly and time consuming. This raises prices and can deny access for consumers in certain markets.
- 2. It damages competitive equity by differently regulating firms that offer similar services.* The differences in regulation are not driven by differences in risks generated by the firms’ activity but by the charter or license status of firms.
- 3. It risks violating political equity among citizens.* A

state that has a large share of the market (such as New York) may end up de facto regulating the national market. Fintech firms would thus face significant economic and regulatory pressure to limit their national product offerings to conform to state-specific rules, in effect limiting citizens’ choices through regulation they had no say in.

MAKING FINTECH REGULATION MORE EFFICIENT AND EQUITABLE

Federal regulators can address some of the problems facing fintech lenders. The Office of the Comptroller of the Currency, for example, has proposed creation of a bank charter for fintech firms. This would give them the powers granted to national banks by the National Bank Act.

The states can also play a major and productive role in

improving fintech regulation. For instance, they could change their lending regulations to make it easy for lenders licensed in one state to lend in other states. However, collaboration with the federal government is likely necessary for truly effective reform. Congress has the broadest authority to address the issues posed by inapt state regulation of fintech. It also could take steps to create a clear and effective regulatory environment for banks and fintech lenders.

CONCLUSION

In the financial sector, new competitors are increasingly leveraging technology to provide greater access, more efficiency, and better value than the status quo. However, they often do not easily fit in the existing regulatory boxes. This is straining regulatory assumptions, including those about whether and how the states or the federal government should regulate fintech firms. A consistent regulatory approach would encourage innovation and access in lending. For this to happen, greater federalization of the rules may be required.

FURTHER READING

- Brian Knight, “Risks to Innovative Credit Posed by Emerging Regulatory and Litigation Trends” (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, January 2017).
- Brian Knight, “Modernizing Financial Technology Regulations to Facilitate a National Market” (Mercatus on Policy, Mercatus Center at George Mason University, Arlington, VA, July 2017).
- Brian Knight, “Federalism and Federalization of the Fintech Frontier” (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, 2017).

ABOUT THE AUTHOR

Brian Knight is a senior research fellow and director of the Innovation and Governance Program at the Mercatus Center at George Mason University. He most recently worked for the Milken Institute, where he headed the FinTech and Capital Access programs. Knight has experience working for a broker-dealer with a focus on the emerging online private-placement market and was the cofounder of CrowdCheck, a company providing due-diligence and disclosure services to companies and intermediaries engaged in online private offerings. He has also served as an attorney for the federal government. He received his law degree from the University of Virginia and his bachelor’s degree from the College of William and Mary.



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