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OPINION | COMMENTARY

Fintech Can Come Out of the Shadows

Firms that make loans and process payments should be chartered and regulated as national banks.

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If it lends like a bank and processes payments like a bank, is it a bank? Maybe not, depending on the outcome of a case pending in the Second U.S. Circuit Court of Appeals. In the lawsuit, New York financial-services superintendent Linda Lacewell claims a company can't be a bank unless it accepts deposits, no matter that it offers other services—consumer loans, credit cards or payment processing—that banks have traditionally

offered. This claim is legally and historically wrong, as well as risky. Consumer protection and the safety and soundness of our financial system are at risk if it succeeds.

The Office of the Comptroller of the Currency determines which companies qualify for charters as national banks or federal savings associations and supervises the activities of those banks to ensure fair access to financial services and the safety and soundness of America's federal banking system. The commitment to safety and soundness has a record: National banks fail less often than state-chartered banks and lose less money when they do.

Unfortunately, the OCC's ability to provide quality supervision shrinks as more banking activity migrates to shadow banks. Before the financial crisis, national banks conducted the majority of consumer lending and virtually all payment activity in the U.S. But the past decade witnessed dramatic change. By 2018 banks' share of personal loans fell to 28% while fintech's share of that market rose to 38%. Fintech unicorns such as Square, PayPal and Stripe have similarly captured a large and growing segment of the payments business that national banks previously dominated.

Two things account for this great unbundling of banking, from the financial supermarkets of the 1990s to the specialty fintech boutiques of today. First, technological changes have created new fintech competitors that can form banking transactions. Second, customer behavior is adapting quickly to the new technologies. Many customers—whether consumers with minor credit blemishes, or small retailers—have voted with their feet and taken their business to specialized (and often cheaper) marketplace lenders and payments providers.

Traditional bank lending and payments have earned low or negative returns in recent years, compared with returns of 50% to 150% for specialized fintech providers in payments, bank and capital markets technologies, information services, and payroll services.

Technological change, customer preferences and market performance tell us that unbundling is inevitable—services that banks have historically provided will increasingly be offered by specialty firms, often with a fintech flavor. Does that mean that services that formerly were subject to federal supervision will now occur predominantly in the shadow banking sector, away from the safety and soundness our agency can provide? Only if the New York lawsuit succeeds in preventing the federal banking system from adapting.

The claim that banks must take deposits contradicts both bank history and bank law. Deposits weren't an important source of funding for chartered U.S. banks in the early 19th century. In the 20th century, credit-card banks funded themselves primarily through securitization of receivables rather than deposits. Banks have always been defined by the types of services they provide—payments and lending—and the specific instruments they use to perform those services necessarily change over time.

Given that banks compete for sources of funding with firms that earn high rates of return, compete with global debt markets for customers seeking to borrow money, and compete with technology companies to provide customer services, banks must adapt or die. In a market economy, customers will obtain loans and receive the payment and other financial services they need in the manner they choose. The question is whether they will receive them on safe and supervised banking platforms or will resort to lightly regulated shadow banks.

So why are New York and other states fighting the OCC's authority to charter national banks that engage in many core banking services but happen not to take deposits? They could simply be protecting turf. Or they could be worried about losing the money they earn from licensing shadow banks. In 2019, New York alone oversaw 113 state-licensed money transmitters, 18 nonbank lending companies, 92 sales finance companies, and other companies, some of which might qualify as national banks. Regulatory assessments alone earned Albany more than \$100 million.

State regulators are not fighting our authority because state regulation is safer or more effective than federal regulation. State-chartered financial companies fail more often than national banks, and experience roughly double the losses when they do. Neither are states suing us to defend a more efficient system of financial services. Does anyone believe that a national lending company or a global-payments processor works better by being regulated by 50 state authorities, rather than by operating under one regulatory framework?

The New York lawsuit is a reminder that consumer preferences evolve and the market and its regulatory structure must evolve too. It took the Supreme Court in 1870 to clarify that national banks may issue certified checks—highly controversial then but taken for granted now. In the late 1960s, at the dawn of the computer age, our agency again fought all the way to the high court to establish that banks could offer data-processing services. In the early 1990s, the justices held that banks could offer variable annuities because

those products served the same purpose as savings accounts. In each of these cases, the forces of the status quo fought change, but progress prevailed to allow the federal banking system to evolve to meet the needs of the customers banks serve.

As one federal court put it in the late 1970s, “the National Bank Act did not freeze the practices of national banks in their nineteenth century forms.” For that same reason, we will fight the battle over fintech charters so customers can choose the financial services they want and we can ensure safety, soundness, and fairness as they do so.

Mr. Brooks is acting comptroller of the currency. Mr. Calomiris is chief economist of the OCC.

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