

MEMORANDUM

To: Committee on Financial Services

From: Digital Assets, Financial Technology and Inclusion Subcommittee Staff

Date: March 8, 2024

Subject: Subcommittee on Digital Assets, Financial Technology and Inclusion Hearing: “Bureaucratic Overreach or Consumer Protection? Examining the CFPB's Latest Action to Restrict Competition in Payments”

On Wednesday, March 13, 2024, at 9:00 a.m. the Subcommittee on Digital Assets, Financial Technology and Inclusion will hold a hearing entitled: “Bureaucratic Overreach or Consumer Protection? Examining the CFPB's Latest Action to Restrict Competition in Payments.” The following witnesses will testify:

- **Carl Holshouser**, Executive Vice President and Corporate Secretary, TechNet
- **Brian Johnson**, Managing Director, Patomak Global Partners, LLC
- **James Kim**, Partner and Head of Fintech Industry Group, Troutman Pepper Hamilton Sanders, LLP
- **Jack Solowey**, Financial Technology Policy Analyst, CATO Institute
- **Christopher Odinet**, Josephine R. Witte Professor of Law, University of Iowa

Background

In November 2023, the Consumer Financial Protection Bureau (CFPB) issued its first “Larger Participant Rulemaking” proposal in eight years.¹ The last larger participant rule was finalized in 2015. The November 2023 proposal is the sixth CFPB rulemaking to define larger participants of markets for consumer financial products and services.

This proposal would expand the CFPB’s supervisory authority over large companies in the “general-use digital consumer payment application” space. However, the CFPB fails to adequately justify the need for this proposal, raising concerns about its necessity. The proposed rule's broad scope could potentially impact companies beyond the purported target, raising concerns about the proposal’s unintended consequences. The flawed cost-benefit analysis supporting the proposal raises additional concerns about the proposal’s economic impact. Further, the CFPB interprets the term “funds” in a novel way to grant the CFPB authorities over digital assets.

¹ Defining Larger Participants of a Market for General-Use Digital Consumer Payment Applications, 88 Fed. Reg. 80197 (Proposed Nov. 7, 2023) (to be codified at 12 C.F.R. pt. 1090).

The proposal represents another unwarranted expansion of CFPB's authority. Without addressing these issues, the proposal in its current form would have negative consequences for businesses, consumers, and competition.

Background on the CFPB's Authorities

Title X of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd Frank) provides the CFPB with supervisory authority over “larger participant[s] of a market for other consumer financial products or services.”² Dodd Frank directs the CFPB to consult with not only the Federal Trade Commission (FTC) but also the appropriate federal financial regulators on larger participant rulemakings. In their most recent proposal, the CFPB appears to have only, “consulted with or provided an opportunity for consultation and input to the FTC.”³

Under Dodd Frank, the CFPB does not need to conclude that a market has higher rates of non-compliance, poses a greater risk to consumers, or is more important to supervise than other markets, as it relates to the large participant rule.⁴ Rather, Dodd Frank provides the CFPB with broad plenary authority to define the market and to supervise market participants, once an entity meets a preestablished threshold.

Once an entity falls under the larger participant rule, the scope of the CFPB’s supervisory authority goes beyond the products and services that initially qualified the entity for supervision.⁵ For example, the CFPB is obligated to report a supervised entity’s potential tax noncompliance to the IRS.⁶ In addition, the CFPB’s supervisory authority extends to the covered entity’s third-party service providers.

Overview of Recent Growth in Digital Payments

Digital payments have played an increasingly important role since the late 2000s. Technological advances with mobile wallets and contactless payments using individuals’ smartphones, have integrated digital payments into Americans’ everyday lives. While the COVID-19 pandemic further catalyzed consumers’ use of digital, peer-to-peer payments (P2P), the adoption of digital, P2P payments in the post-pandemic era has skyrocketed.

A 2022 study by the PEW Research Center found that 76 percent of Americans have used at least one of four well-known P2P payment apps (PayPal, Venmo, Zelle, or Cash App) and that 61 percent of low-income households (households with an annual income lower than \$30,000)

² 12 U.S.C. § 5514

³ *Id.*

⁴ *Supra* note 1, at footnote 25.

⁵ *Id.* at footnote 7.

⁶ 12 U.S.C. § 5514

reported using P2P payment apps.⁷ A survey by McKinsey & Company published just a year later showed a continued increase, with more than nine out of ten consumers indicating they have used some form of digital payment during 2023.⁸ CFPB analysts expect this mass adoption to continue, estimating the value of digital wallet tap-to-pay transactions will grow by over 150 percent by 2028.⁹

In response to the explosive growth in digital P2P payments, the CFPB issued a series of orders to collect information on the business practices of large technology companies operating payment systems in the United States in October 2021.¹⁰ Despite the CFPB failing to publish a report outlining the specific risks these business practices pose to consumers, identify deficiencies in these systems' operations, or take an enforcement action,¹¹ it nevertheless issued a proposed rule.

Overview of the CFPB's November 2023 Proposed Large Participant Rule to Define Digital Consumer Payment Applications

Under the November 2023 proposal, larger participants in this market would be subject to CFPB supervision and examination authority.¹² The proposed market would cover “providers of funds transfer and wallet functionalities through digital applications” that consumers generally use to make payments to other persons for personal, family, or household purposes.”¹³ Examples include many consumer financial products and services that are commonly described as “digital wallets,” “payment apps,” “person-to-person apps,” “P2P apps,” and similar applications. Comments on the proposal were due January 8, 2024. Despite both Republicans and Democrats submitting comment letters requesting the CFPB extend their comment period, the CFPB did not grant an extension.

To be defined as a nonbank covered person under the proposal an entity must provide general-use digital consumer payment applications and have an annual volume of at least five million

⁷ Monica Anderson, "Payment Apps Like Venmo and Cash App Bring Convenience—and Security Concerns—to Some Users," Pew Research Center, (Sep. 8, 2022), <https://www.pewresearch.org/short-reads/2022/09/08/payment-apps-like-venmo-and-cash-app-bring-convenience-and-security-concerns-to-some-users/>.

⁸ McKinsey & Company, "Consumer Digital Payments: Already Mainstream, Increasingly Embedded, Still Evolving," McKinsey & Company, (Oct. 25, 2022), <https://www.mckinsey.com/industries/financial-services/our-insights/banking-matters/consumer-digital-payments-already-mainstream-increasingly-embedded-still-evolving>.

⁹ *Supra* note 1.

¹⁰ Consumer Financial Protection Bureau, “Notice and Request for Comment Regarding the CFPB’s Inquiry Into Big Tech Payment Platforms,” Docket No. CFPB-2021-0017, Notice; request for comment, <https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-tech-giants-to-turn-over-information-on-their-payment-system-plans/>.

¹¹ Krisztian Katona, “Re. CFPB’s Proposed Rule Defining Larger Participants of a Market for General-Use Digital Consumer Payment Applications,” *The Computer & Communications Industry Association* (Jan. 8, 2024) <https://www.regulations.gov/comment/CFPB-2023-0053-0048>, pg. 6&7.

¹² 12 U.S.C. § 5514

¹³ *Id.*

consumer payment transactions. Any nonbank covered person that qualifies as a larger participant would remain a larger participant until two years from the first day of the tax year in which the person last met the larger-participant test. The CFPB claims there are 17 firms that would be subject to the proposal. However, there is significant concern among market participants as to who falls under the scope of the CFPB’s supervision and examination authorities under the proposed rule.

Moreover, the proposed rule would define “consumer payment transaction” as the transfer of funds by or on behalf of a consumer physically located in a state to another person primarily for personal, family, or household purposes. The CFPB breaks the “consumer payment transaction” definition into four distinct elements:

1. Payment transaction must result in a transfer of funds by or on behalf of the consumer. (With a focus on the sending of payment and not receipt);
2. The consumer must be physically located in a state;
3. The funds transfer must be made to another person besides the consumer (This would exclude transfers between a customer’s accounts); and
4. The funds transfer must be for primarily personal, family, or household purposes. For general-use digital payment applications that could also be used for commercial purposes, only consumer payment transactions for personal, family, or household purposes would fall within the scope of the proposed rule.¹⁴

Although the proposed rule does not define “funds,” the CFPB asserts that the definition of “funds” is not limited to fiat currency or legal tender, but also includes digital assets that have monetary value and are readily usable for financial purposes, including as a medium of exchange.¹⁵ As such, the proposed rule captures the transfer of funds in the form of digital assets by, or on behalf of, a consumer could qualify as a “consumer payment transaction.”

Further, the proposed rule would apply to entities providing covered payment functionalities through a digital application for a consumer’s *general use* in making payment transactions. According to the CFPB, the proposal is limited to digital payment applications that consumers can use for a wide range of purposes.¹⁶ The proposed rule also defines two types of covered payment functionalities, a “funds transfer functionality” and a “wallet functionality.”

- “Funds transfer functionality” is defined, in connection with a consumer payment transaction, as (a) receiving funds for the purpose of transmitting them or (b) accepting and transmitting payment instructions.

¹⁴ *Supra* note 1 at 80201 – 80202.

¹⁵ *Id.* at 80202.

¹⁶ *Id.* at 80198.

- “Wallet functionality” includes a product or service that (a) stores account or payment credentials, including in encrypted or tokenized form, and (b) transmits, routes, or otherwise processes such stored account or payment credentials to facilitate a consumer payment transaction.¹⁷

The proposal applies broadly to digital applications that are accessible via computer software programs, mobile phones, or smartwatches that are for general use. Examples of covered technologies include applications that store payment credentials on a phone for use at physical retail locations, peer-to-peer money transfer services, and online merchants that store payment credentials for use by other merchants. However, due to vague definitions in the proposal, the full picture of which firms would be covered remains unclear. The CFPB received more than 60 comment letters providing feedback on the proposal and requesting clarity regarding the proposal’s implementation. It is unclear when the CFPB intends to finalize the proposal or whether the various concerns that were raised will be addressed.

¹⁷ *Id.* at 80201.