UNIVERSITY OF IOWA

Christopher K. Odinet
Josephine R. Witte Professor of Law

Written Testimony of

Christopher K. Odinet
Josephine R. Witte Professor of Law
University of Iowa

Before the United States House of Representatives
Committee on Financial Services
Digital Assets, Financial Technology and Inclusion Subcommittee

"Bureaucratic Overreach or Consumer Protection?
Examining the CFPB's Latest Action to Restrict Competition in Payments"

March 13, 2024
9:00 am ET
2128 Rayburn House Office Building

Witness Background Statement

Christopher K. Odinet is the Josephine R. Witte Professor of Law at the University of Iowa. His teaching and research are the areas of commercial law, consumer finance, and property law, with an emphasis on digital/crypto assets, financial regulation, bankruptcy, and mortgage lending.

Professor Odinet served as a two-time commissioner with the Uniform Law Commission and continues to serve as an advisor to a number of that organization's study and drafting committees. He was recently the reporter for a Uniform Law Commission committee investigating the use of tokens and other crypto innovations in real estate transactions. He also recently represented the United States on a joint committee of the Hague Conference on Private International Law and UNIDROIT studying cross-border transactions involving digital assets.

Before joining the Iowa Law faculty, Professor Odinet served on the faculty at the University of Oklahoma and at the Southern University Law Center. Before joining the academy, he practiced law in the business and finance group at Phelps Dunbar LLP. He holds a J.D. and B.A. from Louisiana State University. In 2022, he was awarded the American College of Commercial Finance Lawyers' Grant Gilmore Award in recognition of superior scholarship in the field of commercial finance.

Professor Odinet has not received any federal grants or any compensation in connection with his testimony, and he is not testifying on behalf of any organization. The views expressed in his testimony are solely his own.

© 2024, Christopher K. Odinet

Mr. Chairman Hill, Ranking Member Lynch, and Members of the Committee.

Good morning. Thank you for inviting me to testify today at this hearing. My name is Chris Odinet. I am a law professor at the University of Iowa, where I teach courses in commercial law, consumer finance, bankruptcy, and property law. I am here today solely as an academic who studies consumer finance and am not testifying on behalf of any organization or individual.

Over roughly the past ten years (and certainly since the COVID-19 pandemic), the way households pay for goods and services has rapidly evolved. Digital payments platforms like PayPal/Venmo, CashApp, and Zelle have become ever-increasingly popular, as they offer consumers convenient ways to transfer money through the use of mobile apps on their smart phones, tablets, laptops, and other electronic devices. According to a 2022 Pew Research Center study, PayPal is used by a majority of United States adults (57%), and 76% of all Americans reported using at least one of the major four digital payment platforms.[1] However, as these platforms become increasingly embedded in the daily financial lives of consumers across the U.S., it is crucial that we examine their business models, their trajectories for continued growth, and the very real potential risks they pose to American households and our broader economy.

The tremendous rise in digital payment platforms comes from a combination of developments in technology, shifts in the preferences of consumers, and the omnipresence of smartphones and similar devices. These platform companies recognize the desire for more seamless financial transactions that incorporate highly user-friendly interfaces—particularly when it comes to sending and receiving money. Network effects have supercharged the growth of these firms as more and more consumers join these platforms, which, in turn, expands the convenience that these platforms can provide to their customers.

At their center, tech companies that focus on digital consumer payments pose very particularized concerns. This is largely due to their business models and the way in which the financial regulatory ecosystem treats these firms. First, digital consumer payment platforms are *nonbanks*, meaning they are firms that provide financial products and services in a bank-like way but that are not chartered as banks and are thus not regulated as banks. Nevertheless, these platforms provide a service that was traditionally within the ambit of banking: *payments*. Payment services were long the province of the banking system, and banks are subject to a significant degree of oversight by public agencies.

Second, as elaborated on in my testimony today, consumer payment platforms have access to massive amounts of consumer financial data, such as how much individuals spend funds, what they spend them on, to whom they pay them to, and from whom they receive money. This treasure trove of data provides consumer payment platforms with valuable insights, which can facilitate targeted marketing and advertising of various products and services. However, custody of such sensitive information can give rise to significant privacy concerns. This access also raises ethical issues about how such information is used and with whom it is shared.

Additionally, as these payment platforms continue to grow, attract more users, integrate further with the larger economy, and ultimately enlarge their market share, they may use this dominance to exert influence over the larger payments ecosystem in ways that we find problematic.

---

[1] Monica Anderson, *Payment Apps Like Venmo and Cash App Bring Convenience—and Security Concerns—to Some Users*, PEW RSCH. CTR. (Sep. 8, 2022).

© 2024, Christopher K. Odinet

This is particularly concerning when considering the ways that big technology companies, which already exert an outsized influence throughout the U.S. and global economy, are integrating digital payment capabilities into their business models. With control over both payment transmission lines and massive amounts of sensitive consumer financial data (paired with other non-financial information about consumers), policymakers are rightly worried about the potential for fraud, discrimination, anticompetitive behavior, and danger to the larger financial system.

One of the major issues for policymakers and regulators who are concerned with guarding against these harms is understanding where the pressure points lie and where breakdowns or fraudulent activity is occurring in the nonbank digital consumer payments ecosystem. Having better visibility into this space helps both protect against breakdowns before they happen as well as flag unlawful business practices before they result in consumer harm. In service to this, the Consumer Financial Protection Bureau's (CFPB) rule titled *Defining Larger Participants of a Market for General-Use Digital Consumer Payment Applications* moves in the right direction toward a system of supervision for these important consumer finance firms. My remarks today will focus on a few broad elements for how supervision of digital consumer payment platforms makes for good public policy across several dimensions.

Leveling the Regulatory Playing Field Between Banks and Nonbanks

As an initial matter, CFPB supervision of nonbank digital consumer payment platforms would level the playing field between the way these platforms are regulated and the way banks—the undergirding firms of the U.S. payment system—are regulated.

To set the foundation, consider the fact that banks play a significant role in the transfer of money.[2] Since most people hold money in a bank deposit account, the easiest way that banks make transfers is when the transfer is between two deposit accounts at the same bank. Since the deposits are liabilities on the balance sheet of the bank, it makes a change to its book-keeping in order to reflect the change; the bank does this in the form of making debits and credits to the accounts. The more common transfer, however, is between a deposit account at one bank and a deposit account at another bank. This type of transfer is effectuated through so-called master accounts that individual banks have at their applicable regional Federal Reserve Banks.[3] Bank-to-bank transfers are effectuated through debits and credits between these master accounts. With the rapid growth in payments over time, additional interbank clearing systems have arisen, such as CHIPS, Fedwire, and FedACH.[4] This has resulted in a handful of major clearing houses now handling most interbank electronic payments—such as the direct deposit of social security benefits, payroll, and tax refunds, as well as the automatic debiting of payments for mortgages, utilities, and the like—before they are ultimately settled between master accounts at the Fed.[5]

Yet, regardless of the structure, **banks** are at the core of the payment system. And the privilege that comes along with having such a favored and central role in the economy is that banks are a unique

[2] *See* Dan Awrey, *Unbundling Banking, Money, and Payments*, 110 GEO. L.J. 715, 735-37 (2022).
[3] Julie Andersen Hill, *Opening A Federal Reserve Account*, 40 YALE J. REG. 453 (2023); *see also* Julie Andersen Hill, *From Cannabis to Crypto: Federal Reserve Discretion in Payments*, 109 IOWA L. REV. 117 (2023).
[4] Awrey, *supra* note 2 at 733-37.
[5] *Id.*

© 2024, Christopher K. Odinet

form of business entity that exist in a highly regulated environment.[6] For example, banks are subject to a host of limitations on what kinds of activities they can undertake,[7] whereas a regular corporation can engage in as many different kinds of business undertakings as it wishes. The creation of a bank is a discretionary act of the government—meaning that the government has the power to decide not to permit a bank to be formed—whereas one can create a simple corporation or limited liability company with a few clicks of a button and little government inquiry.[8] Moreover, the various regulations that govern banking exist at both the state and federal level, whereas corporate law is generally only state law.[9] However, creating and operating a bank is a distinctive type of business undertaking[10]—one deeply interwoven with public subsidies and public duties.[11] Banking law governs the ability of these firms to expand into new geographic areas[12] to offer news kinds of products and services,[13] as well as to merge with or acquire other firms.[14]

For our purposes today, the most critical aspect of banking is the concept of *supervision*. Once a regular business is created, it does not generally need to worry about its operations later being examined by the government. With banks, however, regulators have robust powers to supervise the activities and examine the operations of banks on an ongoing basis (and indeed, they have a duty to do so).[15] This includes what are known as visitorial powers, which authorizes regulatory staff to make unannounced visits to a bank's various offices and demand immediate access to books and records, as well as conduct interviews with bank employees. This is in addition to more regular, periodic, and scheduled visits.[16]

---

[6] MICHAEL P. MALLOY, PRINCIPLES OF BANKING REGULATION (2011).

[7] 12 U.S.C. § 24 (providing powers of national banks); 12 U.S.C. § 1464 (providing powers of federal savings associations); *see also* IOWA CODE § 524.801(1) (providing an example the powers of a state-chartered bank); *see* OCC: ACTIVITIES PERMISSIBLE FOR NATIONAL BANKS AND FEDERAL SAVINGS ASSOCIATIONS, CUMULATIVE (Oct. 2017), https://www.occ.gov/publications-and-resources/publications/banker-education/files/pub-activities-permissible-for-nat-banks-fed-saving.pdf.

[8] *See, e.g.*, DEL. CODE ANN. tit. 8, § 101 (1998) ("Any person, partnership, association or corporation, singly or jointly with others, and without regard to such person's or entity's residence, domicile or state of incorporation, may incorporate or organize a corporation under this chapter by filing with the Division of Corporations in the Department of State a certificate of incorporation which shall be executed, acknowledged and filed in accordance with § 103 of this title."); *see also* 805 ILCS § 5/2.10; NEV. REV. STAT. ANN. § 78.035; *cf* 12 U.S.C. § 24.

[9] Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33 (2006) ("Corporate law is state law."); *see also* Lucian Arye Bebchuk & Assaf Hamdani, *Vigorous Race or Leisurely Walk: Reconsidering the Competition over Corporate Charters*, 112 YALE L.J. 553 (2002) ("In the United States, most corporate law issues are left for state law. . . .").

[10] *See* S & N Equip. Co. v. Casa Grande Cotton Fin. Co., 97 F.3d 337, 346 (9th Cir. 1996) (describing Congress' "more stringent regulation of the banking industry"); *see also* Kim v. Off. of Thrift Supervision, 40 F.3d 1050, 1051 (9th Cir. 1994) (describing banking as being its own industry).

[11] Davis v. Elmira Sav. Bank, 161 U.S. 275, 283 (U.S. 1896) ("National banks are instrumentalities of the federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States.")

[12] 12 U.S.C. § 36(c)(1).

[13] *See* 12 U.S.C. § 84 (prescribing lending limits for national banks); *see also* CAL. FIN. CODE § 1500.1 (limiting when a California state bank can exercise trust powers).

[14] *See, e.g.*, Bank Merger Act, Pub. L. 86-463, 72 Stat. 129 (1960); Bank Merger Act Amendments of 1966, Pub. L. 89-356, 80 Stat. 7 (codified as amended at 12 U.S.C. 1828(c) (2018); *see also* U.S. DOJ, BANK MERGER COMPETITIVE REVIEW (2000), https://www.justice.gov/sites/default/files/atr/legacy/2007/08/14/6472.pdf.

[15] OCC, COMPTROLLER'S HANDBOOK: EXAMINATION PROCESS (June 2018), https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/bank-supervision-process/pub-ch-bank-supervision-process.pdf.

[16] 12 C.F.R. § 4.6 (requiring that regular supervisory visits for federally-chartered banks are either conducted on an annual basis or once every 18-months).

© 2024, Christopher K. Odinet

Moreover, aside from examinations, regulators often issue supervisory guidance to banks. Such guidance comes in the form of informal directives that indicate how regulators believe banks should operate in order to comply with various laws, ranging from disclosures to anti-discrimination, information security, and more. While supervisory guidance does not carry the same weight as a formal enforcement action against a bank, banks generally choose to comply with any informal guidance so as to avoid an official—and more importantly, public—enforcement action.

Importantly, banks can find themselves subject to the supervision of multiple regulators, even if one particular regulator is considered to be their primary prudential regulator. For instance, the Comptroller of the Currency is the primary regulator of national banks and federal savings associations,[17] but the bank will also have to contend with the FDIC and the Federal Reserve. A state-chartered bank will be under the authority of its state banking regulator, but if it has FDIC insurance, then the FDIC also has regulatory authority.

Relative to consumer financial protection obligations—such as the transmission of money—the CFPB also has regulatory authority over banks, including supervision authority, if the bank has more than $10 billion in assets.[18] While this threshold number does leave a number of banks outside CFPB supervision, the ones that are included are significant. While a majority of banks are not supervised by the CFPB, the banks that collectively hold the vast majority of assets are subject to the Bureau's oversight. Additionally, from a payments perspective, the concentration is meaningful. In an influential paper on payments and banking, Professor Dan Awrey notes that at the beginning of 2020, the U.S. "was home to over 4,500 licensed commercial banks, over 5,200 credit unions, and 659 thrifts."[19] But, according to Fed research, "just sixty-six banks—less than 1% of all licensed deposit-taking institutions—accounted for roughly 75% of the total volume of payments between banks."[20] Thus, a concentrated group of very large banks handles the clearing and settlement processes for a vast majority of payment transactions. By having regulatory authority over these large banks, the CFPB wields a significant legal tool in understanding and monitoring the payment system.

Alternatively, consider the equivalent supervision of **nonbanks** who are engaged in payment services, which are sometimes referred to as fintechs. As noted in my introductory remarks, nonbanks are companies that offer financial products and services but that do not themselves have a bank charter.[21] Instead, these are regularly formed business entities that operate like banks but without the same regulatory guardrails. An important detail to observe about nonbanks is that there are many different kinds—all depending on the business activity being undertaken—and that the entry costs are

---

[17] 12 U.S.C. §§ 1 *et seq.*

[18] 12 U.S.C. § 5515. I also note that the corporate family structure of a bank can also loop in other financial regulators. If the bank is owned by another company, then the parent company must organize itself as a bank holding company. 12 U.S.C. § 1841(c); 12 U.S.C. § 1843(a)(1)–(2) (prescribing limitations on bank holding company activities); *see also* 12 U.S.C. § 1843(k)(1) (describing the financial holding company, which is a type of bank holding company that has more expanded permissible activities). Bank holding companies are regulated by the Federal Reserve Board and are subject to strict limitations on the types of activities in which they can engage—essentially, they and their subsidiaries may only engage in the business of banking and in banking-like activities. *See* 12 U.S.C. § 1848a. In practical terms, this means that banks and their affiliates cannot engage in commercial activities. For example, a bank holding company could not own both a bank and a retail merchandise company, a tech firm, or the like.

[19] Awrey, *supra* note 2, at 737.

[20] *Id.* (citing KIMMO SORAMÄKI ET AL., FEDERAL RESERVE BANK OF N.Y. STAFF REPORTS, THE TOPOLOGY OF INTERBANK PAYMENT FLOWS 2–3 (2006)).

[21] For a brief discussion of nonbanks, see Bd. of Governors of Fed. Rsrv. Sys. v. Dimension Fin. Corp., 474 U.S. 361, 363 (U.S. 1986).

© 2024, Christopher K. Odinet

quite variable. At a base level, creating a nonbank can be as simple as filing the necessary paperwork with a particular secretary of state. The type of entity typically chosen for nonbanks is a corporation or a limited liability company.

Nonbanks that offer digital consumer payment services range in their business structure, but all of them depend on the banking system behind the scenes in order to move funds from one place to another. This concept can be best illustrated by looking at an example, such as PayPal.[22] PayPal is a nonbank company that allows its customers to make payments using either pre-funded accounts with or credit furnished by PayPal. If a PayPal user wishes to maintain funds with PayPal to cover payments in the future, they may do so by pre-funding their PayPal account. But, to be clear, this is not the same as holding those funds in a deposit account with a bank. Rather, PayPal accepts the funds and deposits them in its own deposit accounts with its own banks. Those funds are then pooled in PayPal's bank accounts with other customer funds, which are accounted for on the books and records of PayPal. The claim that customers have to those funds is a claim against PayPal—and it is an unsecured claim—rather than against the bank holding the funds.[23] Further, any interest earned on those funds belongs to PayPal, not to the customers. In this way, it is a contract of general deposit but without the benefit of deposit insurance—and interest—like that enjoyed by deposit-holders at banks.[24]

Next, consider a simple transaction between a consumer and a merchant using PayPal.[25] Both parties will have accounts with PayPal. When the consumer makes a purchase, PayPal acts as the intermediary between the consumer and the merchant. PayPal seeks payment for the good or service from the consumer. How that payment is made depends upon how the consumer's payment information is configured. If a deposit account is linked to the PayPal account, then PayPal will seek payment from the consumer's bank where the deposit account is held. If a credit card is linked to the PayPal account, then PayPal will seek payment from the consumer's credit card bank. On the other side of the transaction, PayPal will credit the merchant's PayPal account with the amount of the purchase. Thus, as noted by Professor Adam Levitin, in a "PayPal transaction, there are actually two payments, one to PayPal and one from PayPal to the merchant."[26]

This discussion of PayPal illustrates both the similarities and the differences between when a consumer interfaces with a bank to make a payment and when a consumer does the same through a nonbank payment platform. In the PayPal example, the individual's interaction with the platform is superficially similar to using a bank. The PayPal account is funded with a balance ahead of a transaction (like depositing funds in a bank account) and payments are initiated much like making a typical debit or credit (again, from a bank account). But the actual mechanics are quite different, as there is a powerful and critical intermediary added to the payment transaction (i.e., PayPal itself). The consumer becomes even more removed from the merchant. As more parties and more legs are added to the ultimate payment process, the greater the chances are of losses related to fraud, privacy breaches, or

---

[22] Adam J. Levitin, *Payment Wars: The Merchant-Bank Struggle for Control of Payment Systems*, 12 STAN. J.L. BUS. & FIN. 425, 479 (2007).

[23] *PayPal User Agreement*, PAYPAL (Feb. 8, 2024), https://www.paypal.com/ms/legalhub/useragreement-full ("Holding a PayPal Balance").

[24] *See* Levitin, *Payment Wars*, *supra* note 22, at 479.

[25] ADAM J. LEVITIN, CONSUMER FINANCE: MARKET AND REGULATION 368 (2023).

[26] *Id.*

© 2024, Christopher K. Odinet

the insolvency of the party standing in the middle. This is where consumer protection law—and the need for responsible regulatory supervision—should step in.[27]

Zooming back out to the regulation of nonbanks more generally, depending on the activity in which the nonbank desires to engage, it may have to obtain a license or otherwise register itself with certain governmental agencies in order to engage in certain financial activities. Since this hearing is about digital consumer payment platforms, the most relevant example is a typical money transmitter license.[28] In order to obtain such a license, an individual will make an application to the state's banking or financial services regulator. The applicant will normally have to submit a few years' worth of financial statements,[29] as well as pay a licensing fee (which typically range from a few hundred[30] to a few thousand dollars[31]). The applicant will also have to obtain a surety bond in a given amount—the coverage of which can vary. For example, in Alabama, the maximum amount that can be required is $5,000,000.[32] In Michigan, the maximum amount is $1.5 million.[33] The bonds are meant to serve as a source of funds in the event that customer monies are lost or stolen, but many state statutes do not tie the bond coverage amount to the amount of monetary obligations outstanding. The bond may be in the amount of $500,000, but the company may have $2 million in outstanding monetary obligations—making the bond coverage fall quite short of making all customers whole if even half the funds were lost. There are other requirements relative to net worth and permissible investments, but these too can range from state to state. Alabama's single net worth requirement is $25,000[34] while Michigan's is $100,000 up to a maximum of $1,000,000, depending on the number of locations an entity has.[35]

And even if a given state's money transmitter statute is robust, compliance is another matter. Nonbanks of this kind are subject to examination and reporting, but the degree to which this occurs with regularity depends on the applicable state regulator. Some state regulators have little staff or few resources, while others have multiple missions that include regulating insurance, state banking, and other markets.[36] Yet, from a consumer's perspective, these entities are engaged in payments activities much like that of a bank: consumers interact with them like they would a bank by utilizing their services

---

[27] For a discussion of the benefits of supervision of nonbank mortgage companies, see CHRISTOPHER K. ODINET, FORECLOSED: MORTGAGE SERVICING AND THE HIDDEN ARCHITECTURE OF HOMEOWNERSHIP IN AMERICA (2019).

[28] CONGRESSIONAL RESEARCH SERVICE, TELEGRAPHS, STEAMSHIPS, AND VIRTUAL CURRENCY: AN ANALYSIS OF MONEY TRANSMITTER REGULATION (Aug. 2020), https://sgp.fas.org/crs/misc/R46486.pdf.

[29] *See, e.g.*, MCL § 487.1013(3) (statements for the two prior years); ALASKA STAT. ANN. § 06.55.102 (statement for the prior year, and two years if available); TENN. CODE ANN. § 45-7-107 (statement for the prior year, and three years if available).

[30] *See, e.g.*, ALA. CODE § 8-7A-6 (not less than $500); NEV. REV. STAT. ANN. § 671.050 ("A nonrefundable fee of not more than $500 for the application and survey."); 2. DEL. CODE ANN. tit. 5, § 2307 ("An investigation fee of $172.50 which shall not be subject to refund.").

[31] IOWA CODE ANN. § 533C.202 ($1,000); MCL § 487.1013(4) ($3,600, with an additional $50 per location up to a maximum of $3,000); ARIZ. REV. STAT. ANN. § 6-126 ("$1,500 plus $25 for each branch office and authorized delegate to a maximum of $4,500.").

[32] ALA. CODE § 8-7A-7.

[33] MCL § 487.1013(5); *see also* TENN. CODE ANN. § 45-7-108 (maximum amount is $800,000.00).

[34] ALA. CODE § 8-7A-10

[35] MCL § 487.1013(1)(b). There is typically also a character and fitness component to the application. *See, e.g.*, S.D. CODIFIED LAWS § 51A-17-12. *See* TENN. CODE ANN. § 45-7-110 (describing broad and undefined review standards such as honesty and fairness, as well as trust in the community); WYO. STAT. ANN. § 40-22-110 (same)

[36] 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 (2020).

© 2024, Christopher K. Odinet

to send and receive money, but without the same level of oversight to ensure that the digital consumer payment platform is meeting its legal obligations.

The CFPB's supervision rule is well-justified from this viewpoint, as it establishes a unified and coherent regulatory framework for overseeing the payment system. It brings all consumer payments under the CFPB's supervision, regardless of whether the individual chooses to interface directly with a bank or more indirectly through a nonbank digital consumer payment platform. The CFPB's rule puts the two types of firms on the same regulatory footing. It helps guard against the evasion of consumer financial protection laws that can occur when one set of firms are being supervised and examined by the CFPB and another set, though involved in the same type of consumer financial activity, is not. If nonbank digital consumer payment platforms are providing consumers with the same or substantially similar kinds of payment services that banks provide, then consumers should be able to rely on the same kind of supervision of these nonbanks as they can for banks. This is particularly true since both banks and nonbank digital consumer payment platforms must abide by the same legal rules in a number of respects, such as electronic funds transfer and financial data privacy laws. The CFPB's rule would ensure that certain entities are not more easily able to avoid legal compliance, simply because of their nonbank status.

The Benefits of CFPB Supervision versus Solely Rulemaking and Enforcement

Another benefit that the CFPB's rule brings to the table for digital consumer payment platforms stems from the advantages of supervision itself. Digital consumer payment platforms are already obligated to comply with a host of federal consumer financial protection laws. These include not only the Electronic Funds Transfer Act and its Regulation E, but also financial data privacy laws like the Gramm-Leach-Bliley Act and its Regulation P. Additionally, digital consumer payment platforms are subject to the prohibition on engaging in acts or practices that are unfair, deceptive, or abusive. This later obligation is operationalized through the CFPB's enforcement authority over so-called covered persons,[37] which includes firms that engage in the "transmission and exchanging of funds" as well as the "provision of payments and financial data processing products by technological means."[38]

Collectively, this means that the CFPB can already bring enforcement actions against digital consumer payment platforms. This is in addition to being able to promulgate rules to prescribe what would constitute an unfair, deceptive, or abusive act or practice,[39] as well as rules implementing specific enumerated consumer laws[40] like the Electronic Funds Transfer Act.[41] Naturally, the filing of an enforcement action against a firm can have significant consequences for that firm. It can impact its reputation, both with its current and prospective customers, as well as with its owners and investors. It also can have a significant drain on corporate resources, as management and outside professionals must devote time (usually with accompanying commitments of funds) to manage the litigation.

Supervision has the virtue of allowing the regulator—in this case, the CFPB—to have on-going and regular conversations with the regulated firm. Issues that might constitute a violation or

---

[37] *See* 12 U.S.C. § 5564(a).
[38] 12 U.S.C. § 5481(15).
[39] 12 U.S.C. § 5512(a), 5531.
[40] 12 U.S.C. § 5512(a), 5481(14).
[41] 15 U.S.C. §§ 1693-1693r; 12 C.F.R. § 1005.

© 2024, Christopher K. Odinet

that might be on their way to leading to a violation, may be dealt with through the confidential back-and-forth that forms the basis of supervision. This means that many innocent mistakes that might result from ignorance or benign negligence can be cured or otherwise resolved without ever having to resort to an enforcement action. Supervision also has the benefit of creating an open channel of communication between the regulator and the regulated entity. This means that if the firm wishes to launch a new product or service or engage in a new business model, it has a way of communicating this to the regulator and, in some cases, getting clearance or at least feedback before moving forward. This opportunity for ex-ante discussion can mitigate instances of enforcement after the fact. For all these reasons, supervision rounds out the legal relationship between the CFPB and nonbank digital payment platforms in a way that can help lessen fears about the specter of CFPB enforcement actions, while still providing the CFPB with a powerful tool to ensure that nonbanks are complying with applicable consumer financial laws.

Lastly, while supervision by the CFPB would be new for digital consumer payment platforms, supervision by a financial regulator would not. As mentioned above, while digital consumer payment platforms are not banks, they are required to obtain money transmission licenses from the various states where they transmit funds. A careful browsing of the websites of PayPal, Inc.,[42] CashApp (Block, Inc.),[43] Apple Payments, Inc.,[44] and Google Payment Corp.[45] will reveal a listing of all the various money transmitter licenses they hold from states all across the country. Licensing statutes already give state regulators some degree of supervisory and examination authority over money transmitters.[46] These examinations can range from requiring pre-visitation notice to allowing for unannounced spot-examinations that require no prior communication with the licensee.[47] Additionally, the examination can include "full and complete access to, all records" that the regulator "may reasonably require to conduct a complete examination."[48]

---

[42] *PayPal State Licenses*, PAYPAL, https://www.paypal.com/us/webapps/mpp/licenses?locale.x=en_US (last visited Mar. 9, 2024) (bearing NMLS No. 1679397).

[43] *Licenses*, SQUARE, https://squareup.com/us/en/legal/general/licenses (last visited Mar. 9, 2024) (bearing NMLS No. 942933).

[44] *Apple Payments Inc. Licenses*, APPLE, https://www.apple.com/legal/applepayments/license-information/#:~:text=of%20Financial%20Institutions-,Apple%20Payments%20Inc.,Indiana%20Department%20of%20Financial%20Institutions (last visited Mar. 9, 2024) (bearing NMLS No. 942933).

[45] *Google Payment Corp. Money Transmitter Licenses (U.S. Only)*, GOOGLE, https://support.google.com/googlepay/answer/7160765?hl=en#:~:text=Financial%20Services%20Division-,Google%20Payment%20Corp.,1%2D888%2D986%2D7944 (last visited Mar. 9, 2024) (bearing NMLS No. 911607).

[46] *See, e.g.*, Uniform Money Services Act § 601, cmt 1 (2004), https://www.uniformlaws.org/viewdocument/final-act-8?CommunityKey=cf8b649a-114c-4bc9-8937-c4ee17148a1b&tab=librarydocuments ("Section 601 provides the superintendent with general authority to conduct on-site supervisory exams of licensees and their authorized delegates. This provision is essential to ensure the safety and soundness of licensees and enable the superintendent to examine a licensee's books and records in the event that it is suspected of money laundering or any other violation of this Act."); *see also* CSBS Money Transmission Modernization Act § 4.03 (2024), https://www.csbs.org/csbs-money-transmission-modernization-act#:~:text=Share%3A,and%20regulation%20of%20money%20transmitters ("The [Commissioner] may conduct an examination or investigation of a licensee or authorized delegate or otherwise take independent action authorized by this [Act] or by a rule adopted or order issued under this [Act] as reasonably necessary or appropriate to administer and enforce this [Act], regulations implementing this [Act], and other applicable law, including the Bank Secrecy Act and the USA PATRIOT ACT.").

[47] Uniform Money Services Act § 601(a)(b) (2004).

[48] CSBS Money Transmission Modernization Act § 4.03(b) (2024).

© 2024, Christopher K. Odinet

In essence, digital consumer payment platforms, in their positions as money transmitters, already contend with supervision and ostensibly already have some form of staffing capacity for managing the supervisory activities of their various state regulators. Thus, subjecting these entities to supervisory authority is not an entirely new concept. Indeed, it may be that supervision by the CFPB—which operates as a nationwide regulator—might eventually lead to more and greater coordination between the state-level financial regulators when it comes to assuring compliance with consumer protection laws. This coordination would be important for protecting consumers, as well as for increasing regulatory efficiency and conformity in this area.

Guarding Against the Dangers of Big Tech Data Collection

Another matter which favors CFPB supervision over nonbank digital consumer payment platforms has to do with the collection, use, and distribution of consumer financial data. As technology companies move ever more aggressively into the payments market, one must assume that a primary motivation is to gain access to massive amounts of valuable consumer financial data. This is not to say that these tech platforms do not also wish to earn a profit from facilitating payments. Nonbank platforms of this kind, just like banks, can most certainly earn income from processing fees and the like, but the much greater prize is inevitably the insights that come from surveilling what consumers purchase, from whom they purchase goods and services, and how they otherwise manage their finances.

Indeed, this is not a significant leap to make when one considers that consumer data is the lifeblood of the tech industry's marketing and advertisement-based business models. Having a payments line of business allows these platforms to collect personal financial data that can then be combined with other kinds of data that the platform stockpiles. This can result in a very complete and detailed consumer profile, which can then be used for a host of purposes—both by the platform itself to cross-sell goods and services, as well as by third parties who will pay significant sums for this valuable data.

Troublingly, this data can also be used in discriminatory ways, such as through unlawful differential pricing and marketing. We have already seen instances of fintech companies using machine learning and alternative data to engage in discriminatory practices, particularly in consumer credit markets.[49] Sensitive financial data collected through the provision of payment services, combined with a host of other kinds of particularized consumer data, would give these tech platforms the ability to create—either intentionally or inadvertently—significant consumer harm.

To be sure, the CFPB does have rulemaking and enforcement authority over the federal consumer laws that govern financial data privacy, both as they apply to banks and nonbanks. Yet, as noted above, the bureau's supervision for these laws does not yet extend to nonbank digital consumer payment platforms. This is a huge blind spot, especially considering what I have stated about tech firms and their propensity for using business models that rely on the significant collection of consumer data. The CFPB's new rule would help resolve this massive blind spot, which, in turn, furthers a more complete approach to ensuring consumer trust in the payments ecosystem.

---

[49] *See generally* Christopher K. Odinet, *The New Data of Student Debt*, 92 S. CAL. L. REV. 1617 (2019); *see also* Christopher K. Odinet, *Securitizing Digital Debts*, 52 ARIZ. ST. L.J. 477, 538 (2020); HILARY J. ALLEN, DRIVERLESS FINANCE: FINTECH'S INFLUENCE ON FINANCIAL STABILITY (2022).

© 2024, Christopher K. Odinet

Supervision as a Way to Prevent Harm and Fraud in the Crypto Market

Lastly, the inclusion of crypto/digital asset firms in the CFPB's proposed supervision rule is sorely needed. The business models of these firms are often intimately intertwined with the provision of consumer financial products and services, yet the inner workings of these business models—particularly the transactional structures—are very little understood.[50] Indeed, the public is only coming to understand what happens "under the hood" of these firms by virtue of their death spirals in bankruptcy courts.[51]

Consider two recent crypto company bankruptcies,[52] the consumer harm they produced (and continue to produce), and the ways in which proper consumer protection supervision could have prevented these injuries. The first is that involving Celsius Network LLC, which was a cryptocurrency decentralized depositary, lender, bitcoin miner, and retail investment platform with 1.7 million customers and deposits worth approximately $8 billion.[53] It also sought bankruptcy protection in July 2022.[54] Its Chapter 11 filing came approximately one month after the company froze withdrawals and transfers from customer accounts due to extreme market conditions.[55]

For this hearing focused on the potential supervision of digital asset platforms by the CFPB, the Celsius bankruptcy is noteworthy because of bankruptcy Judge Glenn's precedent-setting January 2023 decision. In that decision, Judge Glenn held that the crypto company debtor—rather than its customers—owns most of the cryptocurrency held pursuant to its "Earn" program.[56] This means that customers not only do not own the assets themselves, but they have only general unsecured claims to recover the value of the assets they deposited into interest-earning accounts on the Celsius platform.[57]

This decision sent shockwaves through the industry because it stripped away the protections customers believed they were entitled to in the event of a cryptocurrency exchange or retail platform bankruptcy.[58] In effect, the decision highlighted the fact that, in the absence of the special rules and

---

[50] *See* Hilary J. Allen, *$=€=bitcoin?*, 76 MD. L. REV. 877 (2017).

[51] *See, e.g.*, Diane Lourdes Dick & Christopher K. Odinet, *The Questionable Virtues of Chapter 11 in the FTX Bankruptcy*, CLS BLUE SKY BLOG (Dec. 7, 2022), https://clsbluesky.law.columbia.edu/author/diane-lourdes-dick-and-christopher-k-odinet; *see also* Diane Lourdes Dick & Christopher K. Odinet, *The Public and the Private of the FTX Bankruptcy*, HARVARD BANKR. ROUNDTABLE (Jan. 31, 2023), http://blogs.harvard.edu/bankruptcyroundtable/tag/diane-lourdes-dick.

[52] The material that follows is taken from a forthcoming law review article exploring recent crypto bankruptcies and the rise of tokens as a mechanism to facilitate the trading of claims in bankruptcy. *See* Diane Lourdes Dick, Christopher K. Odinet, & Andrea Tosato, *Debt Tokens*, U. PA. L. REV. (forthcoming 2024), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4694629.

[53] Jim Probasco, *The Celsius Withdrawal Pause Rattles Crypto World*, INVESTOPEDIA (June 13, 2022), https://www.investopedia.com/crypto-lender-celsius-pauses-withdrawals-5409545.

[54] Chapter 11 Voluntary Petition for Non-Individual, *In re* Celsius Network LLC, No. 22-10964 (Bankr. S.D.N.Y. Jul. 13, 2022).

[55] *See, e.g.*, Tom Wilson, Hannah Long, & Elizabeth Howcroft, *Crypto Contagion Fears Spread After Celsius Network Freezes Withdrawals*, REUTERS (June 14, 2022), https://www.reuters.com/technology/crypto-firm-celsius-pauses-all-transfers-withdrawals-between-accounts-2022-06-13.

[56] Memorandum Opinion and Order Regarding Ownership of Earn Account Assets, *In re* Celsius Network LLC, No. 22-10964 (Bankr. S.D.N.Y. Jan. 4, 2023).

[57] *Id.*

[58] *See, e.g.*, Ronit J. Berkovich, Jessica Liou, & John Marinelli, *Winter Wears On: Celsius Court Rules That Certain Customer Deposits are Property of the Bankruptcy Estate*, WEIL RESTRUCTURING BLOG (Jan. 6, 2023), https://restructuring.weil.com/cryptocurrency-issues/winter-wears-on-celsius-court-rules-that-certain-customer-deposits-are-property-of-the-bankruptcy-estate.

© 2024, Christopher K. Odinet

consumer protections afforded to traditional banking and brokerage accounts, customers bear the insolvency risk associated with crypto platforms. In some cases, this allocation of risk is simply the chosen business model; in others, it is the result of ignorance and/or bad oversight, as the crypto platform could have legally structured itself in such a way that account holders would be vested with a property interest that would be safe from creditors' claims. It may even be that aspects of the business model constituted unfair, deceptive, or abusive acts of practices, but the inner workings of these transactional structures were unknown until it was too late.

The second (now infamous) example is FTX. Founded in 2019 by Sam Bankman-Fried, FTX quickly rose to prominence in the world of digital assets.[59] Its activities covered the whole gamut of crypto finance, encompassing a major exchange, derivatives and options trading, and an NFT marketplace.[60] It operated in multiple jurisdictions and had a significant U.S. presence.[61] At its height, FTX had over one million users worldwide and a valuation of over $32 billion.[62]

FTX's growth was propelled by multiple factors: an opaque relationship with Alameda Research—a trading firm indirectly controlled by Bankman-Fried, investments from renowned venture capital firms, and an aggressive marketing campaign[63] that included naming rights to a Miami stadium and celebrity endorsements.[64] The company and its founder were notably active in philanthropic initiatives and U.S. politics, making substantial donations to political candidates and engaging with regulators.[65]

The collapse of FTX began on November 2, 2022, when a CoinDesk article alleged that the company was using customer funds to cover the losses of its affiliate company Alameda.[66] This sparked a wave of customer panic that accelerated on November 6th when Changpeng Zhao, the CEO of rival exchange Binance, tweeted that his firm would sell off all their FTX holdings.[67] As withdrawals mounted, FTX approached Binance for a buyout, but the deal collapsed on November 9th.[68] With FTX facing an expanding black hole on its balance sheet, Sam Bankman-Fried resigned two days later.[69] That same day, the company filed for bankruptcy protection in Delaware and entered into similar proceedings in the Bahamas a day later.[70]

---

[59] *See generally* MICHAEL LEWIS, GOING INFINITE (2023); *see also* ZEKE FAUX, NUMBER GO UP (2023).
[60] *In re* FTX Trading Ltd., No. 22-11068 (Bankr. D. Del. 2022), https://pacer-documents.s3.amazonaws.com/33/188450/042020648197.pdf.
[61] *Id.*
[62] *Id.*
[63] FAUX, *supra* note 59.
[64] Lora Kelly, *Which Celebrities Are Facing Backlash for Crypto Promotion?*, N.Y. TIMES (Mar. 23, 2023), https://www.nytimes.com/2023/03/23/style/crypto-sec-lindsay-lohan-jake-paul.html#:~:text=Matt%20Damon%3A%20The%20actor%20shilled,and%20love%20for%20%23NFTs.".
[65] *See generally* FAUX, *supra* note 59 (chronicling the rise and fall of FTX).
[66] *See* Ian Allison, *Divisions in Sam Bankman-Fried's Crypto Empire Blur on His Trading Titan Alameda's Balance Sheet*, COINDESK (Nov. 2, 2022) https://www.coindesk.com/business/2022/11/02/divisions-in-sam-bankman-frieds-crypto-empire-blur-on-his-trading-titan-alamedas-balance-sheet/.
[67] Steven Zeitchik, *This Enigmatic Billionaire Just Took Down a Crypto Rock Star*, WASH. POST (Nov. 9, 2023), https://www.washingtonpost.com/business/2022/11/08/binance-ftx-crypto-zhao/.
[68] MacKenzie Sigalos, *Binance Backs out of FTX Rescue, Leaving the Crypto Exchange on the Brink of Collapse*, CNBC (Nov. 10, 2022), https://www.cnbc.com/2022/11/09/binance-backs-out-of-ftx-rescue-leaving-the-crypto-exchange-on-the-brink-of-collapse.html.
[69] Max Zahn, *A Timeline of Cryptocurrency Exchange FTX's Historic Collapse*, ABC NEWS (Dec. 13, 2022), https://abcnews.go.com/Business/timeline-cryptocurrency-exchange-ftxs-historic-collapse/story?id=93337035.
[70] *Id.*

© 2024, Christopher K. Odinet

Shielded by Chapter 11 bankruptcy protection, FTX underwent a series of hearings and motions to consolidate corporate assets, establish creditor committees, and appoint new leadership.[71] The new management's mandate involved stabilizing operations, cooperating with investigators, and maximizing creditor recovery.[72] Throughout the proceedings, judges, examiners, and international law enforcement worked to unravel FTX's intricate web of over 130 corporate entities.[73] Their investigations centered on allegations of misused customer funds, market manipulation, and political donation irregularities,[74] much if not all of which could have been discovered and dealt with if FTX was subject to regular supervision and examination.

Consumer transacting in the crypto space, as well as digital asset firms themselves (ranging from those providing exchange and wallet services to those involved in decentralized finance [DeFi][75]) will benefit from CFPB supervision in a number of ways. For consumers, it will allow a public watchdog with resources at its disposal to have access to these often-opaque business models. For instance, this would provide an opportunity for the regulator to interrogate what the firm says in its public facing material and what it is actually doing behind the scenes.[76] This might include verifying that a stablecoin issuer is actually holding liquid reserves sufficient to meet redemption demand when it so promises,[77] as well as ensuring that customers are properly informed of the risks they undertake when they hold digital assets through an intermediary and that intermediary becomes insolvent.[78]

For the crypto firms themselves, supervision can (as noted in my prior remarks) provide an avenue of communication for the company to discuss its products, services, and business models with the regulator to ensure that it is complying with the federal consumer financial laws. It also helps to police the market such that the bad actors—for which recent years have shown there are many—are driven from the marketplace.[79] In a 2023 report, the Better Business Bureau stated that investment scams, particularly those involving crypto, are now "the riskiest type of cons in the U.S., with crypto fraudsters cheating their victims out of thousands of dollars."[80] The Federal Trade Commission reported that since 2021, over 46,000 individuals have reported crypto-related losses exceeding $1 billion in total, all related to fraudulent schemes and scams.[81] This number represents roughly 25% of all reported losses, thus making crypto the payment method with the highest incidence of financial

---

[71] *Id.*

[72] In January 2023, liquidation proceedings separately began for FTX's Bahamas-based subsidiary FTX Digital Markets. *See* Dietrich Knauth, *FTX Resolves Dispute with Bahamian Liquidators*, REUTERS (Dec. 19, 2023), https://www.reuters.com/technology/ftx-digital-markets-reaches-settlement-with-debtors-2023-12-19/.

[73] Scott Nover, Amanda Shendruck, & Nate DiCamillo, *The Scrollable, Annotated, Incredibly Complex Org Chart of FTX and Sam Bankman-Fried's Fallen Empire*, QUARTZ (Nov. 17, 2022), https://qz.com/ftx-bankruptcy-filing-reveals-a-remarkably-convoluted-c-1849797496.

[74] *See generally* Matthew Goldstein & David Yaffe-Bellany, *FTX Inquiry Expands as Prosecutors Reach Out to Former Executives*, N.Y. TIMES (Feb. 4, 2023), https://www.nytimes.com/2023/02/04/business/ftx-sbf-inquiry-executives.html.

[75] Hilary J. Allen, *Defi: Shadow Banking 2.0?*, 64 WM. & MARY L. REV. 919 (2023).

[76] Juliet M. Moringiello & Christopher K. Odinet, *The Property Law of Tokens*, 74 FLA. L. REV. 607 (2022).

[77] Kara Bruce, Christopher K. Odinet, & Andrea Tosato, *The Private Law of Stablecoins*, 54 ARIZ. ST. L.J. 1073, 1073 (2022)

[78] Adam J. Levitin, *Not Your Keys, Not Your Coins: Unpriced Credit Risk in Cryptocurrency*, 101 TEX. L. REV. 877 (2023)

[79] Khristopher J. Brooks, *Cryptocurrency Fraud is Now the Riskiest Scam for Consumers, According to BBB*, CBS NEWS (Mar. 6, 2024), https://www.cbsnews.com/news/crypto-scam-risk-bbb-report/.

[80] BBB INSTITUTE FOR MARKETPLACE TRUST, RISK REPORT (2023), https://www.bbbmarketplacetrust.org/riskreport.

[81] Emma Fletcher, *Reports Show Scammers Cashing in on Crypto Craze*, FTC (June 3, 2022), https://www.ftc.gov/news-events/data-visualizations/data-spotlight/2022/06/reports-show-scammers-cashing-crypto-craze#crypto1.

© 2024, Christopher K. Odinet

fraud during this period. Naturally, the benefit of rooting out fraud runs both ways, benefiting the honest players in the market as well as preventing consumers from being harmed in the first place.

Conclusion

In closing, the tremendous growth of digital consumer payment platforms—both those in the U.S. and abroad—has fundamentally transformed how consumers pay for goods and services in the real economy. While they indeed offer convenience, these nonbank platforms also raise a host of public policy concerns, ranging from data privacy, market dominance, financial fraud, and broader systemic risk.[82]

As these nonbank payment platforms become ever more embedded in the American economy, appropriate oversight and supervision is crucial in protecting U.S. households, as well as maintaining a safe, competitive payments landscape. The CFPB's new larger participant rulemaking for supervising digital consumer payment platforms is much needed and very much aligned with these goals. Indeed, considering the growth of these platforms and their current market power, it is a regulatory move that is long past due. To be sure, more is needed from regulators in order to better and more fully understand and mitigate the risks posed by the increasing influence of big tech writ large. But the CFPB's current move to gain visibility into the often-opaque world of nonbank digital consumer payment platforms is a much needed and a very positive step in the right direction.

[82] Hilary J. Allen, *Payments Failure*, 62 B.C. L. REV. 453 (2021).

© 2024, Christopher K. Odinet