PaymentsCompliance

Regulate In Haste, Repent At Leisure, Bank Lobbyists Warned

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Leveling the regulatory playing field between U.S. banks and disruptive payment providers by wrapping the latter in red tape may hinder those calling for parity, leading industry experts have warned.

The Clearing House (TCH), a 153 year-old banking association and payments company, is pushing legislators to address gaps in data security practices of alternative payment providers (APPs) in a contentious white paper.

Banks are subject to extensive regulatory, supervisory, and enforcement scrutiny by their regulators with respect to privacy and data security.

TCH lobbyists argue that APPs such as Apple and Square are piggybacking on this and providing payment services "on the backbone of existing bank payment systems while capitalizing on innovations in communications platforms."

TCH, which is entrenched within the banking industry, said its members are aggrieved that APPs are "managing to avoid the reach of the traditional financial regulators."

However, Jason Oxman, the chief executive of influential Washington, D.C. payments trade group Electronic Transactions Association, said a balance can be struck which does not include creating more rules.

Oxman told PaymentsCompliance he could understand the anger in the banking world, and it may be time for the U.S. government to loosen some ties to let them compete.

"Perhaps it shouldn't be the case that the newer, smaller innovators are compounded with regulation that brings them into the sphere of banking, but that the rules restricting banks from innovating in the same way need to be looked at," he said.

"We represent both banks and new tech companies, we encourage them to talk to one another, work

together."

He said driving a wedge between the innovators and the banks would harm business and put consumers at risk.

"My point of view is one of always looking for a level playing field, and it may be time for the government to start looking at reducing the piles of regulation and red-tape the banks are subject to," he said.

"This will bring all the participants in line and give breathing room for the bigger organisations to experiment, innovate or even partner up with the newcomers."

TCH stated APPs with weak data security practices are only punished if they suffer a breach discovered by the government.

TCH used this as a call for more regular examinations and enforcement actions by regulators.

Payments lawyer Andrew Lorentz, leader of Davis Wright Tremaine's Washington, D.C. prepaid and emerging payments practice, said: "The paper seems to be backward facing; looking to apply pervasive regulation to the innovators and disruptors rather than finding a new ground or basis for regulation going forward."

"It doesn't talk about the basis to establish a need for new regulation; they are looking at trying to apply the existing regimes more pervasively," said Andrew Lorentz of Davis Wright Tremaine.

In a view shared by Joshua Rosenblatt and Howard Herndon of Frost Brown Todd LLC, Lorentz said the many advantages banks retain over small payment processors were glossed over.

"I think my point of view is this is much more likely to chill useful innovation than it is to help, although the purpose of the paper doesn't seem to be fostering innovation but rather trying to quiet a perceived competitive challenge," he said.

Rosenblatt, a Nashville-based electronic payments senior associate, added: "It is interesting; there is a reason we require the banks to face all these regulatory restrictions and hurdles, and that is because at the end of the day they are the ones holding the money.

"Start-ups, payment apps, we have to ask ourselves the question do we want them to be nimble, flexible, innovative, or do we want them to be secure, as defined by regulation?"

Herndon, leader of the Frost Brown Todd payments team, agreed: "That is a repeated theme — 'what they are doing is just like banks, therefore they should be treated like banks', then you read throughout the document, which is well written, it talks in terms of making sure there is a level playing field from a regulatory standpoint."

Lorentz outlined one of the major differences: "The technology culture that drives many of the disruptive companies is not readily compatible with bank culture and vice versa, which compounds the challenges of working together — which all of the disruptive companies in the paper are obliged to do given the position of the banks.

"You have integrated solutions like Apple which have the OS and the hardware, you've Google with the OS, Samsung with the hardware and a version of the OS, but in all cases there is a dual customer relationship with the banks and the platform providers having direct access to the customer."

Herndon also picked up on the competition element.

"They say Consumer Financial Protection Bureau (CFPB) and Federal Trade Commission (FTC) need to regulate these APPs, but at the same time they say while they are regulating them, they want to make it clear FTC will not be applicable to firms subject to data security regulations by prudential regulators, banks," he said.

"[Banks] want CFPB, FTC to do their thing, as regards to APPs, but not make them subject to that as they are regulated elsewhere."

He also added that TCH may not get what it wishes for in calling for more oversight.

"By saying they need to be regulated by these other groups, and examined, you don't know they are going to end up with the same regulatory regime, we don't know that," he warned.

"The article suggests that the regulatory regime the banks operate under is working and efficient, and it suggests that everyone else should be similar to that."

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