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Fintech Adoption Poised For Growth In US Despite Lag

By **Philip Rosenstein**

Law360 (August 20, 2019, 9:00 PM EDT) -- The adoption of fintech products that provide online banking and money transmission services has been uneven across the globe, with U.S. consumers lagging behind those in China and India, but with regulatory clarity potentially on the horizon, some see the potential for a surge in use in the U.S.

According to an Ernst & Young study first published in May, fintech adoption in the United States, measured by respondents who have used two or more different kinds of fintech products, is at 46%, well below the average across the globe. By comparison, fintech adoption in both China and India is 87%, and its 82% in Russia. The average of the 27 nations surveyed came in at 64%.

The survey results were based on respondents' use of fintech products within five categories: money transfer and payments, budgeting and financial planning, savings and investments, borrowing, and insurance.

A number of roadblocks exist in the U.S. that have slowed fintech adoption, but industry experts told Law360 that clearing some of the regulatory uncertainty around banking, lending and payment services could pave the way to flourishing fintech adoption in years to come.

The dual banking system in the U.S. raises numerous compliance questions that can scare off smaller fintech startups and delay the rollout of fintech products, according to industry experts. Not only that, the comfort and familiarity consumers have with legacy banking and financial services in the U.S. can dampen wholesale adoption of novel fintech products when compared to consumers in countries like India and China, where the proportionally larger unbanked population has a more direct avenue to fintech adoption.

"[Fintech companies] will benefit from guidance that would give their investors the comfort of knowing that their product is on the right path," John Kromer, a partner at Buckley LLP who works with fintech clients, told Law360. "And that could speed up time to market."

Fintech companies have also had to deal with regulatory questions around privacy and cryptocurrencies, which are both in a period of flux as federal and state regulators weigh their options.

Despite the slow start for fintech adoption domestically, attorneys and experts who spoke with Law360 see a bright future for fintech in the U.S. as demand for more innovative financial products emerges.

"Whether it's the data that can be picked up off of mobile and social and how that can inform better financial products around saving and investing, there's a lot more personalization that we're going to see in the years ahead, a lot more integration that we're going to see, and that's going to drive continued adoption, certainly in the U.S.," Matt Hatch, a partner at EY who was on the survey's steering committee, told Law360.

The Balkanized financial regulatory system in the U.S. has spurred some groups to work to standardize much of the licensing requirements that vary by state. Fintech companies that are not partnering with nationally chartered banks face a steep road to overcome the regulatory burdens needed to launch a new financial product.

As companies await a decision on the viability of the Office of the Comptroller of the Currency's fintech charter, the Conference of State Banking Supervisors has charged ahead with its Vision 2020 plan aiming to provide consistency across money services business licensing requirements.

The cost and time it takes to register in all relevant states in which a fintech company may want to do business can create considerable barriers to entry for many smaller players, and the CSBS says it wants to address that and is working on a model payments law.

"You can spend a long time trying to navigate your way through the process," Kromer said. "Whether that's figuring out how your products are regulated in each state" or applying for all the required licenses, fintech startups may not have the time or money, he said.

Even when fintech companies do partner with banks, the regulatory landscape has been unsteady in the wake of the Madden decision.

The Second Circuit's 2015 decision in Madden v. Midland Funding called into question the validity of interest rates on bank-originated debt that is later transferred to nonbank partners, such as fintech firms. The decision largely rejected the "valid-when-made" doctrine stating that a loan's interest rate remains legal as long as it was legal when the loan was made, regardless of who ends up eventually holding the loan.

It is unclear whether the Madden precedent, which has been widely criticized, will be fixed in the courts, but legislators seem to be potentially moving on this front. There appears to be more urgency in Congress to deal with the Madden fallout, with legislation directly addressing the issue introduced in 2018.

The bipartisan Protecting Consumers' Access to Credit Act, or H.R. 3299, took aim at Madden and passed in the House in February 2018, while the Modernizing Credit Opportunities Act, or H.R. 4439, was introduced in 2017 in the House and would have addressed the question of whether a bank is the true lender if it forms a partnership with a fintech company.

"I think that Madden and the true-lender cases create a lot of uncertainty for both banks and fintech companies on how to develop a lending platform in a way where they have some confidence about the interest rate they can charge and whether there's licensing required," Michael Nonaka, co-chair of Covington & Burling LLP's financial services group, told Law360. "And I think that is having a chilling effect on these types of platforms."

Regulatory clarity on lending issues and more could open up the U.S. market to increased fintech adoption, he suggested.

"There's a lot of legal work in developing the agreements" between fintech companies and banks, Nonaka said. "But I think if you were to have stability in the framework for true lender and the Madden valid-when-made, that would go a long way."

Part of what has bolstered fintech adoption in China, India and other parts of Asia is the emergence of "mega-apps" that can, for example, provide banking services and book you a car. One such company, Grab, received a $2 billion investment from SoftBank and plans, among other things, to launch an electronic health care service.

It has been reported that Uber is hiring for a fintech group, and both it and fellow ride-hailing app Lyft are involved in the Libra Association that looks to launch a Facebook-led cryptocurrency.

"We see in a highly adopted region like China, this concept of the mega-apps," Hatch said. "So in the U.S. fintech propositions tend to be a bit more narrow. We see that broadening over time."

"A lot of these fintech providers [will] either develop partnerships with financial institutions, or incumbents, or each other to cover a broader spectrum of products," he added, which will help increase adoption in the U.S.

--Editing by Breda Lund and Alanna Weissman.