

The Banking Law Journal

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Consumer Financial Protection Bureau Proposes to Supervise Larger Participants in the Market for Digital Payment Applications

*By Valerie Hletko, Eric Mogilnicki, Michael Nonaka and Andrew Smith**

In this article, the authors discuss the Consumer Financial Protection Bureau's proposed rulemaking relating to digital payment applications.

The Consumer Financial Protection Bureau (CFPB) has issued a notice of proposed rulemaking¹ that would extend the CFPB's authority under Section 1024 of the Dodd-Frank Act to supervise larger participants in certain designated markets for consumer financial products and services to nonbank providers of "general-use digital consumer payment applications" (the Proposed Rule). The CFPB previously has exercised this authority to designate for supervision larger participants in five markets for consumer products and services: consumer reporting, consumer debt collection, student loan servicing, international money transfers (remittances), and automobile financing.²

The CFPB press release announcing the Proposed Rule acknowledged the widespread use among consumers and commercial firms of digital applications for consumer retail payment transactions, including sending money to friends and family. The Proposed Rule is intended in part to foster a level playing field between banks and larger non-bank financial institutions that provide consumer payment services. The press release includes a reminder that the CFPB currently has regulatory and enforcement authority over both banks and non-bank financial institutions that provide payment services.

The Proposed Rule is intended to enable CFPB examiners to conduct examinations of larger non-bank participants' compliance with consumer financial services requirements, including the prohibition on unfair, deceptive, and abusive acts or practices, funds transfer requirements, and privacy requirements.

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¹ https://files.consumerfinance.gov/f/documents/cfpb_nprm-digital-payment-apps-lp-rule_2023-11.pdf.

² 12 C.F.R. Part 1090, Subpart B.

THE SCOPE OF COMPANIES POTENTIALLY SUBJECT TO CFPB SUPERVISION UNDER THE PROPOSED RULE IS COMPLEX AND INFORMED BY A NUMBER OF DEFINITIONS AND EXEMPTIONS

The Proposed Rule, like the other five CFPB larger participant rules, defines the relevant market for consumer products and services. This market definition circumscribes the types of companies that may be subject to CFPB supervision. The Proposed Rule's threshold for a larger participant determines the specific companies operating in the relevant market that will be subject to supervision.

The relevant market under the Proposed Rule consists of companies that "provide a general-use digital consumer payment application," which is defined to mean "providing a covered payment functionality through a digital application for consumers' general use in making consumer payment transaction(s)." The Proposed Rule also defines certain terms used in this market definition:

- The term "consumer payment transaction(s)" means "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 term includes transfers of consumer funds and transfers made by extending consumer credit, except for the following four categories of transactions that are exempt from the definition:
 - International money transfers subject to the existing larger participant rule for such transfers;
 - A transfer of funds by a consumer that is linked to the consumer's receipt of a different form of funds, such as a transaction for foreign exchange, or that is excluded from the definition of "electronic fund transfer" in Section 1005.3(c)(4) of Regulation E, which implements the Electronic Fund Transfer Act;³
 - A payment transaction conducted by a person for the sale or lease of goods or services that a consumer selected from an online or physical store or marketplace operated prominently in the name of such person or its affiliated company; and
 - An extension of consumer credit that is made using a digital application provided by the person who is extending the credit or that person's affiliated company.

³ The exclusion in Section 1005.3(c)(4) of Regulation E applies to transfers of funds the primary purpose of which is the purchase or sale of a security or commodity regulated by the Securities and Exchange Commission (SEC) or Commodities Futures Trading Commission (CFTC), purchased or sold through a person regulated by the SEC or CFTC, or held in book-entry form by a Federal Reserve Bank or federal agency.

- “Covered payment functionality” means a “funds transfer functionality,” a “wallet functionality,” or both.
- “Funds transfer functionality” means, in connection with a consumer payment transaction, (1) receiving funds for the purpose of transmitting them, or (2) accepting and transmitting payment instructions.
- “Wallet functionality” means a “product or service that stores account or payment credentials, including in encrypted or tokenized form, and transmits, routes, or otherwise processes such stored account or payment credentials to facilitate a consumer payment transaction.”
- “Digital application” means “a software program a consumer may access through a personal computing device, including but not limited to a mobile phone, smart watch, tablet, laptop computer, desktop computer.”
- “General use” refers to “the absence of significant limitations on the purpose of consumer payment transactions facilitated by the covered payment functionality provided through the digital consumer payment application.”⁴
- Parsing these definitions and exemptions, a non-bank financial institution that provides peer-to-peer payment services in which funds from the sender’s bank account are transferred to the bank account of the recipient would be included in the market definition. Likewise, a non-bank financial institution would be included in the definition if it hosts a digital wallet that holds various third-party payment credentials that the consumer can access and use for payments without presenting a physical payment card.

THE THRESHOLD FOR A LARGER PARTICIPANT IS 5,000,000 ANNUAL CONSUMER PAYMENT TRANSACTIONS

A company is a “larger participant” in the defined market if it provides annual covered consumer payment transaction volume of at least five million transactions and was not a “small business concern” during the preceding

⁴ Under the Proposed Rule, a payment functionality provided through a digital consumer payment application for consumer payment transactions would not have general use under the definition if the application is solely used: (1) to purchase or lease a specific type of services, goods, or other property, such as transportation, lodging, food, an automobile, a dwelling or real property, or a consumer financial product or service; (2) to purchase certain types of prepaid accounts excluded from Regulation E’s definition of “prepaid account,” including health savings and similar accounts, transit accounts, closed-loop government-issued accounts for limited use at government facilities, or certain types of gift cards and gift certificates; (3) to pay a specific debt or type of debt including repayment of an extension of consumer credit; or (4) to split a charge for a specific type of goods or services (e.g., restaurant or other similar bill splitting).

calendar year under the Small Business Act. “Annual covered consumer payment transaction volume” means “the sum of the number of consumer payment transactions that the nonbank covered person and its affiliated companies facilitated in the preceding calendar year by providing general-use digital consumer payment applications.”

The Proposed Rule estimates that approximately 17 entities will be larger participants in the market and subject to CFPB supervision if the proposal is finalized.

THE PROPOSED RULE IS A CONTINUATION OF THE CFPB'S INTEREST IN REGULATING TECHNOLOGY COMPANIES THAT PROVIDE PAYMENT SERVICES

The Proposed Rule is the latest development in a series of CFPB orders and inquiries pertaining to technology companies' payments activities. In October 2021, the CFPB issued orders⁵ collecting information from large technology companies that operate payments systems in the U.S. in order to better understand how these companies use payment data and manage data access. In August 2022, the CFPB warned⁶ digital marketing firms that they must comply with federal consumer financial protection laws when using behavioral targeting techniques. In September 2023, the CFPB issued guidance⁷ highlighting the impacts of technology companies' policies and practices that govern tap-to-pay on mobile devices such as smartphones and watches.

⁵ <https://www.consumerfinance.gov/about-us/newsroom/cfpb-orders-tech-giants-to-turn-over-information-on-their-payment-system-plans/>.

⁶ <https://www.consumerfinance.gov/about-us/newsroom/cfpb-warns-that-digital-marketing-providers-must-comply-with-federal-consumer-finance-protections/>.

⁷ <https://www.consumerfinance.gov/data-research/research-reports/big-techs-role-in-contactless-payments-analysis-of-mobile-device-operating-systems-and-tap-to-pay-practices/>.