

Acting Comptroller Michael J. Hsu

Remarks before the Federal Reserve Bank of Philadelphia

Fifth Annual Fintech Conference

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“Modernizing the Financial Regulatory Perimeter”

Thank you for inviting me to speak today at the Federal Reserve Bank of Philadelphia’s Fifth Annual Fintech Conference. It is an honor and pleasure to open this year’s event.

This morning I would like to talk about modernizing the financial regulatory perimeter, building on remarks I recently gave to the Blockchain Association and the American Fintech Council.¹

Typically, changes to the reg perimeter are driven by responses to crises and failures. I will argue today that given the pace and breadth of innovation, we cannot wait and should be proactive.

By any measure, the growth and expansion of fintechns and cryptocurrencies has been astounding. Some headline stats help tell the story. Five years ago, when the first Fintech Conference was being organized, the market capitalization of the fintech industry was far behind that of the banking industry, and the total market cap of all cryptocurrencies was around \$100

¹ See Remarks by Acting Comptroller of the Currency Michael Hsu at the Blockchain Association (September 21, 2021), at <https://www.occ.gov/news-issuances/speeches/2021/pub-speech-2021-101.pdf>. Remarks by Acting Comptroller of the Currency Michael Hsu at the American Fintech Council Fintech Policy Summit (November 3, 2021), at <https://www.occ.gov/news-issuances/speeches/2021/pub-speech-2021-115.pdf>.

billion. Today, just five years later, the market caps of the largest fintechs rival those of the largest banks. The market cap of cryptocurrencies is rapidly approaching \$3 trillion.²

Beneath these headline numbers lie several important questions. At what point do fintech and crypto firms begin to function like banks? Are the risks the same? Would bringing them into the bank regulatory perimeter be the right solution? What would be lost by doing so? What are the risks of maintaining the status quo? How should bank regulators and the bank regulatory perimeter adapt?

Underpinning these questions is the assumption that banks and banking are “special.”³ Their specialness requires a breadth and intensity of regulation and supervision that is different than for any other industry. Banks’ specialness derives from their role in supporting the broader economy, their interconnectedness with each other, and the confidence-sensitive nature of their business models. Banks need to be safe and sound because a loss of trust and unexpected failure can infect healthy peers and impact the broader economy. At what point might the same be said for certain fintech and crypto firms?

To answer these questions, it helps to be specific about the problems that need to be solved. I will focus on two.

Synthetic Banking

Banking consists of three bundled activities: taking deposits, making loans, and facilitating payments. In the early 2010s, fintechs began to unbundle the payments leg, offering

² See [All Cryptocurrencies | CoinMarketCap](#)

³ [Annual Report of the Federal Reserve Bank of Minneapolis, Annual Report 1982 : Are Banks Special | FRASER | St. Louis Fed \(stlouisfed.org\)](#)

goods and services aimed at improving customers' payments experiences. By and large, such competition has been healthy and beneficial for consumers and businesses.

The largest payments fintechs have not stopped there, however. Many have augmented their platforms and expanded into adjacent areas, such as extending various forms of credit and offering interest on cash held.⁴ Today, a range of fintechs provide seemingly the full suite of banking and investment services—including in cryptocurrencies—with the convenience of tech. These fintechs are reassembling the three legs of banking synthetically, outside of the bank regulatory perimeter. This is what I mean by the term “synthetic banking.”

In “A Brief History of the U.S. Regulatory Perimeter,” Tabor et al. note that the financial reg perimeter has been an ever changing mix of “positive grants” and “negative restrictions.”⁵ While it has constantly evolved, the overarching framework has been relatively stable: “For the last 150 years, federal financial laws have followed the same rough and ready rule: Because you do, you are; and because you are, you do.”⁶

Given the growth of the fintech industry, I believe we are rapidly approaching the point where we need to define what synthetic banking is. “Because you do, you are.” What exactly constitutes “doing”? Where should that line be drawn? By providing that clarity ex ante, we can hopefully avoid having to define it ex post, after a crisis or failure, which is what drives most evolutions of the reg perimeter.

⁴ Refer to [The Battle For Your Deposits Intensifies And That's Good News For Savers | Bankrate.com \(bankrate.com\)](https://www.bankrate.com/bankrate.com)

⁵ Tabor, Nicholas, Katherine Di Lucido, and Jeffrey Zhang “A Brief History of the U.S. Regulatory Perimeter,” (August 2021) [The Fed - A Brief History of the U.S. Regulatory Perimeter \(federalreserve.gov\)](https://www.federalreserve.gov)

⁶ Vardoulakis, Alexandros, Asad Kudiya, Byoung Hwa Hwang, Courtney Demartini, Dan McGonegle, Gavin Smith, Jess Cheng, Katherine E. Di Lucido, Kathy Wilson, Jeffery Y. Zhang, Joseph Cox, Mary L. Watkins, Meg Donovan, Nicholas K. Tabor, Nick Ehlert, and Stacey L. Schreft, “Lessons from the History of the U.S. Regulatory Perimeter” (October 2021) [The Fed - Lessons from the History of the U.S. Regulatory Perimeter \(federalreserve.gov\)](https://www.federalreserve.gov)

To answer these questions, we cannot just focus on activities. We also have to take into account the nature of fintech-bank “partnerships.” These arrangements enable fintechs to offer banking services to customers—facilitating payments, holding deposits, and offering credit—and often customers are unable to distinguish between providers. Of course, not all arrangements are equal. To some, “banking-as-a-service” is a harbinger of the future, in which the comparative advantage of technology firms to amass users shifts the bank business model away from consumer interaction and towards facilitation.⁷ To others, these are simply “rent-a-charter” arrangements, which allow fintechs to skirt a host of rules at the expense of customer protection and bank safety and soundness.⁸ Thus, modernizing the bank regulatory perimeter cannot be accomplished by simply defining the activities that constitute “doing banking,” but will also likely require determining what is acceptable in a bank-fintech relationship.

Fragmented Supervision of Universal Crypto Firms

Today no crypto firm is subject to comprehensive consolidated supervision. This means that there are gaps in supervision, and risks can build out of the sight and reach of regulators. A typical corporate structure will have a holding company over a number of subsidiaries, some of which may be regulated, others of which will be unregulated. (The extraordinary losses at AIG in 2008, which necessitated forceful government intervention, originated out of an unregulated subsidiary.) Without a consolidated, holding company supervisor—that is, an agency or group of agencies able to see the big picture and empowered to oversee all subsidiaries, including the

⁷ Refer to [Forging Fintech Partnerships Through Banking as a Service | Bank Business News \(bankbusiness.us\)](#); [How community banks can thrive in a post-pandemic world | Finextra \(finextra.com\)](#)

⁸ Refer to [Fintech and Consumer Protection: A Snapshot \(March 2019\) | National Consumer Law Center \(nclc.org\)](#); [CBA Urges CFPB to Address Growing Consumer Risk in Under-Regulated Fintech Lending Market | Consumer Bankers Association \(consumerbankers.org\)](#); [Regulatory Inaction on Digital Asset Rules Could Leave Consumers with Few Options in Regulated Banking Sector | Bank Policy Institute \(bpi.com\)](#)

unregulated ones—no one outside of the firm can understand how the firm as a whole operates and how much risk it is taking.

Historically, the concept of consolidated supervision has been revised only after crisis or failure. It was adopted internationally by banking authorities after the closure of BCCI in 1991, in the aftermath of massive money laundering and fraud at that bank. It was expanded to systemically important (nonbank) financial institutions like AIG after the 2008 financial crisis. If we were to follow precedent, we would wait for a large crypto firm to take excessive risk and implode, or grow to such a size as to be systemically important, before subjecting it to consolidated supervision.

Alternatively, we could start now, by considering which crypto activities should be separated; where the line for comprehensive, consolidated supervision should lie; and how such supervision can best be achieved.

Of course, none of these questions can be answered and implemented by the OCC, or *any* regulatory agency, alone. To be effective, the regulatory agencies, including state regulators, must learn to interact differently and define success differently. There needs to be less regulatory competition and more cooperation, less parochialism and more teamwork, less go-it-alone independence and more *interdependence*. In a crisis, I have found that the regulatory community does an exemplary job of working together and functioning as one team. To modernize the regulatory perimeter, we are going to need to do that on a business-as-usual basis. Working with our federal and state partner agencies, the OCC stands ready to help lead the way.

Conclusion

Until recently, the bank regulatory perimeter was determined by the second part of Tabor’s phrase: “[B]ecause you are, you do.” In other words, only properly chartered banks could engage in the business of banking, and regulators had the power to limit what and how they did that.

Things have changed. Technological advances and digital adoption have enabled nonbanks to “do” banking—to facilitate payments, hold deposits, and extend credit—thus shifting the focus to the first part of Tabor’s phrase: “Because you do, you are”. This is further complicated by the rapid growth of cryptocurrencies, which has been accompanied by the emergence of partially regulated crypto firms, leaving significant opportunities for hidden vulnerabilities to develop in a \$3 trillion and growing market.

Historically, a crisis or unexpected failure would provide the impetus for updating the bank regulatory perimeter and bringing those who need regulation into the perimeter. Our collective experience with derivatives in the late 1990s and leading up to the 2008 financial crisis, however, suggests that proactive prevention may be a better path. If we can define synthetic banking, determine which crypto activities should be separated, and identify the attributes of crypto firms warranting consolidated supervision, we may be able to temper the excesses of the boom-bust-reform cycle.

The goal is not to stop business cycles, but to maintain trust. In my opinion, the most damaging thing from the 2008 financial crisis was the widespread loss of trust that resulted. It is one thing to lose one’s money. It is another thing to lose one’s faith in the system.

The participants in this conference are uniquely situated to help. I have found that there are very few people who are fluent in banking and finance, technology and coding, and

supervision and regulation. And yet, the optimal outcome likely requires taking the best attributes of each world and synthesizing them to enable a modern, safe, sound, and fair financial system. This conference embraces that spirit. I look forward to hearing what comes out of today's and tomorrow's discussions and to engaging on how we can and should modernize the financial regulatory perimeter.

One final note. Soon the federal banking agencies will be issuing a short statement that describes the interagency "crypto sprint" that concluded recently. The OCC will also provide clarity on the recently concluded review of crypto-related interpretive letters. The message from both is that the agencies are approaching crypto activities very carefully and with a high degree of caution. We expect banks to do the same. To the extent the OCC's prior communications have been interpreted as tacit encouragement to engage in crypto activities, the forthcoming releases will clarify that safety and soundness is paramount. The releases should not be interpreted as a green light or a solid red light, but rather as reflective of a disciplined, deliberative, and diligent approach to a novel and risky area. We will proceed carefully and cautiously and will hold banks to the same.