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January 2025

Fintech Banking Memo

Fintech banks operating primarily through mobile apps and websites, have emerged as disruptive forces within the financial services industry. These institutions offer traditional banking services such as savings and checking accounts, loans, and payment services with the convenience of 24/7 accessibility through a digital interface. Fintech banks often partner with traditional financial institutions to provide the fintech bank's products and services. The emergence of fintech banks represents a transformative shift in the banking sector, offering unprecedented access, affordability, and convenience for consumers and businesses alike. Fintech banks eliminate the overhead of traditional branch-based banking, leveraging innovative technologies to provide low-cost, user-friendly financial services. These advancements align with the Trump Administration's pro-growth, innovation-driven economic policies, presenting a significant opportunity to enhance financial inclusion and stimulate market competition.

What are Fintech Banks?

Fintech banks are digital-only banks (considered fintechs) that operate primarily through mobile apps and websites. While there are no brick-and-mortar fintech banks, several fintech banks have attracted substantial customer bases: Chime (over 22 million accounts); SoFi Bank: (over 5 million accounts); and Varo Bank (over 3 million accounts). Other fintech banks include Acorns, Current, Lili, Dave, and MoneyLion.

Some fintech banks operate under their own banking licenses, while others partner with traditional banks to use their banking licenses. The Office of the Comptroller of the Currency has issued a small number of national bank charters to non-depository fintech companies engaged in the business of banking. Most states offer charters for trust companies or specialty banks to provide trust services without necessarily offering core commercial bank services.

What Advantages Do Fintech Banks Offer?

Fintech banks offer financial services similar to those of traditional banks, such as savings and checking accounts, loans, and payment and money transfer services. These services are accessible from anywhere with an internet connection. Due to regulatory changes, such as allowing third-party platforms to access bank data, as well as other regulations that encourage competition in financial services, fintech banks have been able to grow rapidly. These institutions have a fully digital interface and are typically accessible through a smartphone app or web-based platform (24/7 accessibility). Fintech banks rely on cloud computing and generate revenue through transaction fees, service charges for premium features, interest on loans, and sometimes by reinvesting deposits in the interbank lending market.

Fintech banks offer a number of specific advantages:

- *Financial Inclusion*: Fintech banks can more effectively reach the "unbanked" population by providing accessible and affordable banking services, thereby promoting financial inclusion. Accessing services at traditional banks can be challenging for many consumers. Fintech banking eliminates many of those barriers.

- *Innovation*: By leveraging technology, fintech banks can introduce innovative products and services, enhancing customer experience and potentially driving competition within the banking sector.

- *Efficiency*: Fintech banks operate with lower overhead costs compared to traditional banks due to their digital-first approach, allowing them to offer competitive rates and fees. Many fintech banks offer higher interest rates on savings accounts than traditional banks, and lower fees for services such as account maintenance and international money transfers.

- *Enhanced Privacy and Security*: Fintech banks leverage cutting-edge encryption and cybersecurity technologies to safeguard customer data, often exceeding the standards of traditional banking systems. By operating entirely in a digital environment, fintech banks can implement advanced fraud detection algorithms and biometric authentication methods, reducing risks associated with physical transactions at bricks and mortar locations. Fintech banks also offer consumers more private and secure transaction tools, such as numberless credit and debit cards.

- *Greater FDIC Protection*: Fintech banks can offer higher FDIC insurance by partnering with multiple banks instead of the standard $250,000 limit available to traditional banks.

- *Convenience*: Fintech banks are fully digital, so customers can manage their finances through secure apps anytime and anywhere.

- *Robust Budgeting and Controls*: Fintech banks excel in providing better budgeting and financial controls, especially for families and children, by offering user-friendly apps with built-in tools for tracking spending, setting savings goals, and managing allowances. Parents can monitor transactions in real-time, set spending limits, and approve purchases, fostering financial literacy in a safe and controlled environment.

- *Fast and easy account opening*: Customers can usually open a fintech bank account online in minutes. Advances in technology offer the same customer protection tools that are present in opening accounts at traditional banks.

- *Credit Building Tools*: Fintech banks offer innovative and secure ways to help consumers build credit through products like the credit builder cards. These tools enable users to make everyday purchases while automatically reporting payments to credit bureaus, all without fees or the risk of overspending, thanks to their no-interest and secured spending structure.

- *Customer service*: Most fintech banks offer 24/7 customer support through various channels.

- *Digital wallets*: Fintech banks offer digital wallets that allow customers to store payment information and make payments without having to enter their details repeatedly.

- *Centralized account management and expense monitoring*: Fintech banks allow customers to track and manage their expenses, and automate tasks like bulk payouts and account verification.

- *Comprehensive loan services:* Fintech banks offer a digital experience that allows customers to easily sign up for accounts and start using the services on their own.

- *Antidote to Traditional Banking Oligopoly*: Fintech banks are a powerful antidote to the oligopoly in traditional banking, where the largest four banks dominate and often offer similar products with limited differentiation—much like airlines. By introducing more choice, innovation, and customer-centric services, fintech banks empower consumers with alternatives tailored to modern needs, breaking the cycle of consolidation and lackluster competition.

U.S. Approach to Fintech Banking Under the Biden Administration Hindered Innovation and Competition

The regulatory framework governing fintech banks continues to evolve. Many offer FDIC insurance through their partner banks, but the fintech banks themselves do not answer to a primary regulator (unless they have some sort of charter). The current Administration principally has focused on the risks of fintech banking rather than the many clear benefits that innovation in this space can offer.

For example, a November 2022 Treasury report[1] highlighted several purported regulatory risks affiliated with fintech banking. Among other items, the report highlighted risks associated with fintech banks' data security and privacy, asserting that the digital nature of fintech banks requires robust data security measures to protect sensitive customer information from cyber

[1] U.S. Treasury Department, *Assessing the Impact of New Entrant Non-bank Firms on Competition in Consumer Finance Markets* (Nov. 2022), available at https://home.treasury.gov/system/files/136/Assessing-the-Impact-of-New-Entrant-Nonbank-Firms.pdf.

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threats and privacy breaches. The report also raised concerns about the potential for regulatory arbitrage, asserting that non-bank firms, including some fintech banks, may exploit regulatory gaps to gain competitive advantages without being subject to the same level of supervision as traditional banks. Treasury contended that nonbanks should not be allowed to offer all of the same products and services as traditional banks because their supervisory framework is less robust.

In 2023, the CFPB issued a proposal to supervise larger nonbank companies that offer services like digital wallets and payment apps.[2] The proposal would require certain nonbank financial companies, including larger firms handling more than five million transactions per year, to comply with the same rules as large banks, credit unions, and other financial institutions already supervised by the CFPB. This proposal was ultimately finalized in November 2024, but the CFPB narrowed the rule's scope to "count only transactions conducted in U.S. dollars" and increased the threshold to firms handling more than fifty million transactions per year.[3]

The current Administration also has assumed a skeptical posture toward banks' relationships with third parties, hindering the ability of fintech banking to grow. For example, the Fed, FDIC, and OCC issued final Interagency Guidance on Third-Party Relationships Risk Management,[4] which calls out bank-fintech partnerships within its purview, underscoring the risks raised by these partnerships. And earlier this year, these same bank regulators issued a statement reminding banks of potential risks associated with third-party arrangements to deliver bank deposit products and services.[5] The agencies also requested additional information on a broad range of bank-fintech arrangements, including with respect to deposit, payments, and lending products and services.

Potential Opportunities to Advance Fintech Banking

It is critical for U.S. regulators to adopt a more balanced approach that recognizes the benefits that fintech banking offers consumers and take steps to foster innovation in this space so that the U.S. does not fall behind its international competitors. Fintech banks represent a

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[2] Consumer Financial Protection Bureau, Proposed Rule, *Defining Larger Participants of a Market for General-Use Digital Consumer Payment Applications* (Nov. 7, 2023), available at https://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-new-federal-oversight-of-big-tech-companies-and-other-providers-of-digital-wallets-and-payment-apps/

[3] Consumer Financial Protection Bureau, Final Rule, *Defining Larger Participants of a Market for General-Use Digital Consumer Payment Applications* (Nov. 21, 2024), available at https://www.consumerfinance.gov/about-us/newsroom/cfpb-finalizes-rule-on-federal-oversight-of-popular-digital-payment-apps-to-protect-personal-data-reduce-fraud-and-stop-illegal-debanking/.

[4] Federal Reserve, FDIC, OCC, Final Interagency Guidance, *Managing Risks Associated with Third Party Relationships* (June 6, 2023), available at https://www.fdic.gov/news/financial-institution-letters/2023/fil23029.html.

[5] Federal Reserve, FDIC, OCC, *Agencies Remind Banks of Potential Risks Associated with Third-Party Deposit Arrangements and Request Additional Information on Bank-Fintech Arrangements* (July 25, 2024), available at https://www.occ.treas.gov/news-issuances/news-releases/2024/nr-ia-2024-85.html.

significant opportunity to enhance financial inclusion, drive innovation, and improve customer experience within the banking sector. However, it is crucial to strike a balance between fostering innovation and mitigating risks. By adopting a tailored, pro-innovations regulatory approach, strengthening third-party risk management, and prioritizing consumer protection, policymakers can create an environment that allows fintech banks to thrive while safeguarding the stability of the financial system and the safety of consumers.

Provided below are several steps that U.S. regulators should consider taking to craft a regulatory framework that will allow Americans to safely enjoy the benefits of the fintech banking model.

- *Promote Responsible Innovation*: Regulatory frameworks should encourage innovation in financial services while ensuring consumer protection and financial stability. Bank regulators should expand the reach of "Innovation Hubs" and "Regulatory Sandboxes" with a mission to encourage the development of innovative new products and services such as those that fintech banks offer.

- *Tailored Regulatory Approach*: Regulators should consider a tiered regulatory approach based on the size, complexity, and risk profile of fintech banks. Smaller fintech banks could benefit from a lighter regulatory touch, while larger institutions may require stricter oversight.

- *Strengthen Third-Party Risk Management*: Regulators should provide clear guidance on managing third-party risks associated with bank-fintech partnerships. This guidance should address due diligence, oversight, and data security requirements.

- *Enhance Consumer Protection*: Policymakers should ensure adequate consumer protection measures are in place, including clear disclosures, dispute resolution mechanisms, and safeguards against unfair or deceptive practices. These measures need not be implemented in a manner that stifles innovation and consumer access and choice.

- *Foster Collaboration*: Regulators should facilitate collaboration between fintech banks, traditional banks, and technology providers to share best practices and address emerging challenges and opportunities.

- *Encourage Middle-Market Regional Bank Participation*: Policymakers should consider incentivizing middle-market regional banks to partner with fintechs to offer fintech banking services. These banks offer a balance of stability and agility. Smaller banks are limited in what products and services they can offer, and large banks are less able and willing to partner with fintechs.

- *Grant CRA Credit for Financial Inclusion Efforts*: Banks partnering with fintechs to expand access to banking services should receive Community Reinvestment Act (CRA) credit for promoting financial inclusion.

- *Address the Potential Role of Cryptocurrencies*: Given the increasing demand for cryptocurrency integration, policymakers should establish clear guidelines for fintech banks offering crypto services while mitigating associated risks. By integrating crypto solutions, fintech banks could provide simplicity in financial management by providing access to banking, investment, and crypto accounts in one place and help to optimize the provision and use of financial services.

- *Allow Market to Determine Winners and Losers:* The Biden Administration has prioritized paternalistic regulations such as setting interest rate caps and limiting the amount of fees that banks can charge. Because competition promotes innovation and greater access to services for underserved populations, it is critical instead to allow the marketplace to decide winners and losers rather than pursuing dangerous price-setting policy initiatives.

Conclusion

A new Administration presents an opportunity to streamline the regulatory environment to foster innovation and avoid fragmentation in the fintech banking sector by encouraging regulators at the state and federal levels to harmonize rules to create a clear and consistent environment for innovators and existing financial institutions. It is critical to modernize regulations for an array of financial products and activities and to promote the development of service partnerships between banks and nonbank firms. The fintech banking model has the power to make the provision of financial services more efficient and accessible for the benefit of millions of American consumers.