Square Peg Meets Round Hole: Regulatory Responses to Challenges Created by Innovation in Banking

*By Jonice Gray Tucker, Daniel Stipano, Kari Hall, Brendan Clegg, and Anthony Carral**

During the past decade, an underlying tension between the financial sector's embrace of innovative products and services and the regulatory framework that governs the industry surfaced—and that tension has since become even more acute during the COVID-19 pandemic. Facing pressure from customers' twenty-first century expectations and competition from emerging fintechs, banks began implementing technological advances into their businesses even before disruptions to the U.S. financial system caused by the coronavirus placed a spotlight on the critical role those advances will play in banking's future. This article highlights a number of areas of law where the governing framework erected during bygone eras has hindered the industry's adoption of innovation and proven incompatible with the digital revolution that has changed the business of banking. This article also explores the successes and failures of a range of approaches adopted by the federal regulatory agencies responsible for the framework's design, implementation, and enforcement as they try to mitigate this tension. The degree to which these agencies embrace innovation in the industry, and use the tools at their disposal to encourage its continuation, will go a long way toward determining whether banks can weather this period of economic disruption, meet the changing needs of their customers, and fend off competition from industry upstarts.

For years, the business of banking in the United States seemed immune to an oft-repeated maxim: the only constant in life is change. Yet finally, change has come, and it is moving with rapid speed. During the past decade, technological advances have impacted the nature of financial products and services, as well as the ways in which they are delivered. Competition in the industry has been fierce, pitting banks and non-banks against each other in a struggle to retain customers or attract new ones by making their offerings faster, more efficient, and more convenient. Established industry heavyweights have faced challenges from emerging financial technology ("fintech") companies endeavoring to meet the demands and expectations of today's customers, many of whom operate in a

* Jonice Gray Tucker, Daniel Stipano, and Kari Hall are partners and Brendan Clegg and Anthony Carral are associates at Buckley LLP. The authors specialize in work with banks, nonbank financial institutions, and other companies providing financial products and services.

mobile environment, with an expectation of 24-7 accessibility. In order to compete, banks have become more creative with product development and service delivery, further leveraged technology, and, in some cases, partnered with their fintech competition—steps that have triggered a dramatic evolution in an industry once viewed as traditional and staid.

We have seen an acceleration in many of these changes since the spring of 2020, as the world has grappled with the health, social, and financial shock waves created by the novel coronavirus (COVID-19). The social distancing required by COVID-19 has changed the way we do business, with the closure of physical locations, and many consumers choosing to stay away from those that remained open. In response, both consumers and financial institutions have turned to technology to bridge the gap while in-person financial services were significantly limited, escalating the use of technology developed in the past decade. It remains to be seen whether such significant reliance on technology to provide and receive financial services will become the new normal, but we already were on our way before this global pandemic hit.

The business of banking is changing, yet in many ways, the regulatory framework governing financial products and services has failed to keep pace. Indeed, the laws that control this highly regulated industry often were enacted decades before today's current, innovative products and services were even imagined. As an industry that depends on an understanding of, and adherence to, regulatory expectations, it is best served by requirements that avoid ambiguity and interpretational challenges. Federal legislation and rulemaking have been among the most reliable means of erecting regulatory guardrails. Paradoxically, however, these methods of defining operational parameters also are the most burdensome, and such action cannot be undertaken lightly, particularly where the issues to be addressed hold the potential to evolve before regulatory change becomes effective. For these and other reasons, financial regulators often have taken more subtle approaches to governance when hesitant to call for legislative change or to embark on the often-onerous rulemaking process. In some instances, these approaches have created further uncertainties, as the financial services sector has tried to fit a new square peg into a preexisting round, regulatory hole.

This article explores the tension between existing financial services regulations and the burst of innovation in the financial services sector, focusing on examples spanning the regulatory landscape. These include compliance with Regulation D,[1] the Electronic Funds Transfer Act and Regulation E,[2] the Bank Secrecy Act and anti-money laundering laws,[3] regulations applicable to brokered deposits,[4] and the Community Reinvestment Act.[5] In addition, we examine approaches undertaken by financial services regulators as they have

1. *See* Regulation D, 12 C.F.R. §§ 204.1–204.136 (2020).
2. *See* Electronic Funds Transfer Act, 15 U.S.C. §§ 1693–1693r (2018); Electronic Fund Transfers (Regulation E), 12 C.F.R. §§ 1005.1–1005.36 (2020).
3. *See* Bank Secrecy Act, 31 U.S.C. §§ 5311–5332 (2018).
4. *See* 12 C.F.R. § 337.6 (2020).
5. *See* Community Reinvestment Act, 12 U.S.C. §§ 2901–2908 (2018).

attempted to keep pace with technological advances and adapt in the wake of the COVID-19 pandemic.

1. Regulation D

The Federal Reserve Board's ("FRB") April 2020 amendments to Regulation D are a notable example of a federal banking agency's embrace of the rulemaking process to overturn a longstanding requirement and accommodate the business realities of modern banking in a time of crisis.[6] While widely recognized as outmoded, the motivation behind the FRB's changes to certain provisions of Regulation D cannot be divorced from the Agency's recognition of rapid transformations to financial services and the needs of consumers in a world that has been turned upside down by COVID-19.

Regulation D implements parts of the Federal Reserve Act that require depository institutions to maintain reserves against certain deposits, including certain account types, by defining the deposits subject to the reserve requirements and delineating how the reserve calculations are made.[7] This regulation serves as a source for the distinction made by depository institutions in their product offerings between what are colloquially referred to as checking accounts and savings accounts. Checking accounts fall into Regulation D's defined term "transaction accounts," which require reserves, while savings accounts fall within the Regulation's defined term "savings deposits," which escape reserve requirements.[8] One way in which Regulation D drew the line between transaction accounts and savings deposits was by limiting the number of certain transfers (so-called "convenient" transfers) or withdrawals that customers could make from a savings deposit to six transfers per month.[9] Thus, by regulation, checking accounts served as far more conducive vehicles for everyday financial transactions, while customers had to carefully plan when and how to utilize funds in their savings accounts. The fact that savings accounts generally pay a higher interest rate than most checking accounts made convenient transfer planning even more important, as customers have a financial incentive to hold as much money as possible in their savings accounts.

Today, businesses and individuals rely on, and expect, ease of money movement through their accounts, regardless of how that account is categorized. Electronic transfers, available to customers with the click of a mouse or tap of a mobile phone, increasingly reflect standard practice for the movement of money throughout the modern world, whether to make payments to third parties, or between the customer's own accounts to best manage funds. Despite this reality, until April 2020, the transfer limitation for savings accounts—ensconced in banking systems

6. *See* Regulation D: Reserve Requirements of Depository Institutions, 85 Fed. Reg. 23445 (Apr. 28, 2020) (to be codified at 12 C.F.R. pt. 204).

7. *See* 12 C.F.R. §§ 204.4–204.5 (2020) (implementing requirements set out in the Federal Reserve Act § 19, 12 U.S.C. § 461(b)(2) (2018)).

8. *See* Regulation D: Reserve Requirements of Depository Institutions, 85 Fed. Reg. at 23445 (to be codified at 12 C.F.R. pt. 204).

9. *See id.*

due to the definitional terms of Regulation D—persisted, vastly reducing the accessibility to funds maintained in savings accounts.

The elimination of the transfer limitation imposed by Regulation D on savings accounts occurred virtually overnight. In March 2020, the FRB reduced the reserve requirement ratios to zero percent, in light of forthcoming changes in monetary policy in preparation for the impact of COVID-19, to an "ample reserves regime."[10] The interim final rule amending Regulation D—which became effective immediately on April 24, 2020—subsequently removed the six-transfer limit from the regulation's definition of savings deposit, and eliminated the requirements for depository institutions to prevent transfers in excess of that limit or monitor the accounts for limit violations.[11] As the FRB explained in announcing the interim final rule amending Regulation D just one month after the reserve reduction became effective, the elimination of the reserve requirements for transaction accounts rendered Regulation D's distinction between those accounts and savings deposits unnecessary.[12]

With this noted, industry participants can readily attest that the co-existence of inconsistent, inconvenient, and sometimes unworkable regulatory requirements typically does not spur quick action by the banking regulators. Frequently, there is not a quick fix, causing confusion and operational challenges for financial institutions attempting to satisfy obligations. Viewed in this light, the FRB's rapid movement in aligning the different elements of its regulatory regime through a rulemaking is particularly notable. Beyond the discordance with modern banking practice—which was not unique to developments in 2020—the FRB expressly acknowledged that the disruptions caused by COVID-19 accelerated its course of action.[13] In particular, the FRB recognized that remote access to funds in the face of the pandemic would be even more critical, reflecting its understanding that numerous bank branches and in-person facilities were closed as part of mitigation efforts to stop direct human-to-human interaction.[14]

The elimination of the transfer limit will provide expanded consumer access to funds needed to address myriad significant financial repercussions brought on by the COVID-19 pandemic. The FRB has not indicated an intention to reverse course by reinstating the convenient transfer limitations on savings accounts after the country emerges from this pandemic; we do note, however, that the interim final rule granted a sixty-day comment period.[15] On May 13, 2020, the FRB updated its Savings Deposits Frequently Asked Questions, which provide information regarding the elimination of the convenient transfer limitations on savings accounts, stating that its "monetary policy framework is not a short-term

10. *See* Press Release, Bd. of Governors of the Fed. Reserve Sys., Federal Reserve Actions to Support the Flow of Credit to Households and Businesses (Mar. 15, 2020), https://www.federalreserve.gov/newsevents/pressreleases/monetary20200315b.htm.

11. Regulation D: Reserve Requirements of Depository Institutions, 85 Fed. Reg. at 23446.

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.*

choice," and the FRB does not have plans to reinstate transfer limits.[16] Instead, the FRB indicated that adjustments to the definition of savings accounts may be made in response to comments received on the interim final rule and if future conditions warrant.[17] By indicating that it has no plans to reinstate the convenient transfer limitation on savings accounts, the FRB seemingly acknowledges that such a limitation is outdated and unnecessary in today's fast-paced, online world.

As institutions move to address this significant shift in banking practice facilitated by the lifting of this regulatory requirement, they will undoubtedly encounter a host of downstream consequences necessitating careful consideration, given the direct relevance of the regulatory change to customer banking habits and the country's attempt to work through the business disruption and financial crisis caused by COVID-19. Notwithstanding the deluge of compliance questions likely to arise from the definitional change to Regulation D, the amendments evidence swift, decisive action by a federal banking regulator to address an outdated, anachronistic holdover from a different age of banking, crystallized by the acute financial effects brought on by the COVID-19 crisis. The FRB's embrace of the rulemaking process as the vessel of change, and its willingness to act decisively, stand in contrast to other examples of regulatory behavior described in this article, where regulations have similarly failed to keep pace with innovation in the banking sector, and the regulators have struggled to use all available and effective tools at their disposal to address these widening gaps.

II. The Electronic Funds Transfer Act and Regulation E

Regulation E provides yet another example of a circumstance where regulatory requirements have lagged significantly behind financial innovation. Regulation E implements the Electronic Fund Transfer Act ("EFTA"), which was established in 1978 to provide the basic rights, liabilities, and responsibilities of participants who use or offer electronic fund transfer ("EFT") and remittance transfer services.[18] The EFTA and Regulation E were promulgated by the FRB with a strong consumer protection focus, providing protections related to myriad types of consumer-based EFTs, such as those initiated through an ATM, point-of-sale ("POS") terminal, automated clearing house ("ACH"), or telephone bill-payment plan.[19]

The Dodd–Frank Wall Street Reform and Consumer Protection Act transferred rulemaking authority for Regulation E from the FRB to the Consumer Financial

16. *Regulations: Savings Deposits Frequently Asked Questions*, Bd. Governors Fed. Reserve Sys., https://www.federalreserve.gov/supervisionreg/savings-deposits-frequently-asked-questions.htm (last updated May 13, 2020).

17. *Id.*

18. *See* Electronic Fund Transfers (Regulation E), 12 C.F.R. §§ 1005.1–1005.36 (2020); *see generally* Electronic Funds Transfer Act, Pub. L. No. 95-630, 92 Stat. 3641 (1978) (codified as amended at 15 U.S.C. § 1693–1693r (2018)).

19. *See* Electronic Fund Transfers, 45 Fed. Reg. 8248 (Feb. 6, 1980) (to be codified at 12 C.F.R. pt. 205).

Protection Bureau ("CFPB" or "Bureau") in 2011.[20] The CFPB has engaged in significant rulemaking since 2011, including issuing the Remittance Rule contained in Subpart B to Regulation E in 2012 and the Prepaid Accounts Rule in 2016, which was amended in 2017.[21] While the CFPB has engaged in new rulemaking specific to certain types of products or transactions, the core Regulation E provisions governing EFTs have remained suspended in time. As a result, they fail to account for the realities of today's world, in which both banks and non-banks push to achieve new and innovative payments processes and systems that provide faster and more convenient EFTs. Interestingly, the CFPB noted the need for Regulation E modernization more than two years ago, but as of the date of this article, does not appear to have made much, if any, progress.[22]

Landscape altering technological developments have occurred since the EFTA was passed, and many existing EFT systems have undergone substantial changes following the implementation of Regulation E. Advances particularly relevant for Regulation E include the introduction and development of person-to-person payment ("P2P") platforms such as Zelle, Venmo, and GooglePay. An estimated 96 million Americans engaged in at least one P2P transaction in 2019,[23] and that number is set to rise significantly in 2020 in light of COVID-19, as many consumers have had no choice but to rely on technology to make purchases. These evolving technologies have transformed the methods and circumstances under which consumers initiate and receive EFTs and, as a result, have necessitated the modernization of certain key products and services under the regulatory framework to ensure that the EFTA's purpose is carried forth by adapting the regulatory requirements to conform to these new channels and circumstances. While much of Regulation E needs to be reconsidered and updated to align the regulation with technological advancements, two areas are especially in need of modernization due to potential conflicts created by new technology. These are overdraft disclosures and error resolution.

A. Overdraft Disclosures

Under Regulation E, financial institutions are permitted to provide overdraft services and assess overdraft fees in exchange for paying consumers' transactions that exceed the available balances in the consumers' checking accounts.[24] Prior

20. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1084, 124 Stat. 1376, 2081–82 (2010) (codified as amended at 15 U.S.C. § 1693b (2018)).

21. *See* Electronic Fund Transfers (Regulation E), 77 Fed. Reg. 6194 (Feb. 7, 2012) (to be codified at 12 C.F.R. pt. 1005); Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth In Lending Act (Regulation Z), 81 Fed. Reg. 83934 (Nov. 22, 2016) (to be codified at 12 C.F.R. pts. 1005 & 1026); Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E) and the Truth In Lending Act (Regulation Z); Delay of Effective Date, 82 Fed. Reg. 18975 (Apr. 25, 2017) (to be codified at 12 C.F.R. pts. 1005 & 1026).

22. *See* Consumer Fin. Prot. Bureau, RIN 3170-AA79: Regulation E Modernization (2018), https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201804&RIN=3170-AA79.

23. Caroline Cakebread, *Who's Using P2P Payments in the US?*, EMarketer (Dec. 5, 2018), https://www.emarketer.com/content/the-mobile-series-mobile-peer-to-peer-payments-infographic.

24. 12 C.F.R. § 1005.17(a) (2020).

to 2009, financial institutions had significant discretion relating to the way in which overdraft protection programs operated and applied to consumers' deposit accounts.[25] This discretion, in conjunction with a significant increase in debit card transactions, led to increased overdraft fees and complaints by consumers and consumer protection groups.[26] In response to these complaints, the FRB finalized a rule in 2009 requiring financial institutions to obtain consumers' affirmative consent ("Opt-In Requirement") before assessing fees for overdraft services in connection with ATM and one-time debit card transactions.[27] The Opt-In Requirement requires financial institutions to provide a number of disclosures in accordance with pre-defined content and formatting requirements. Among other things, a financial institution must provide: (i) a description of the overdraft service; (ii) the fees imposed; (iii) the limits of the fees charged; and (iv) disclosure of the opt-in right.[28]

Under the EFTA, consumers are afforded a private right of action against financial institutions that fail to meet the Opt-In Requirements for their overdraft service.[29] However, Congress also provided financial institutions a safe harbor from EFTA liability for "any failure to make disclosure in proper form" if a financial institution utilized the model form issued under Regulation E ("Form A-9") or a substantially similar substitute.[30] The safe harbor also requires the institution to describe its overdraft service in a clear and understandable way.[31] Form A-9 was designed to provide consumers with adequate information regarding the scope and coverage of overdraft services in connection with the most common EFT methods in use at the time.

Form A-9 does not address information that has become important to overdraft processing, including which balance calculation method is used to determine overdrafts or the use of newer payment vehicles, including P2P transfers. In a nutshell, Form A-9, a model form designed to help consumers make decisions regarding overdraft services today, continues to reflect the deposits and payments environment of 2009. Despite these coverage shortfalls, many financial institutions, rightfully, have continued to rely upon the language in the form to insulate them from liability in connection with any breach of a disclosure obligation under Regulation E—relying on the permission granted by the EFTA itself.

The CFPB attempted to move the needle on this issue in August 2017 when it announced its intention to update and improve Form A-9; at that time it released

25. *See* Joint Guidance on Overdraft Programs, 70 Fed. Reg. 9127, 9128 (Feb. 24, 2005).

26. *See id.* at 9129.

27. *See* Electronic Fund Transfers, 74 Fed. Reg. 59033 (Nov. 17, 2009) (to be codified at 12 C.F.R. pt. 205). The Opt-In Requirement is currently codified in Part 1005 of Title 12. *See* 12 C.F.R. § 1005.17(b)(2)(ii) (2020). The Opt-In Requirement does not extend to overdraft fees assessed in connection with check, ACH, or recurring debit card transactions.

28. *See* 12 C.F.R. § 1005.17(d) (2020).

29. *See* 15 U.S.C. § 1693m(a) (2018).

30. *See id.* § 1693m(d)(2). The Model Form was issued by the FRB in 2009 and was subsequently adopted by the CFPB in 2011. *See* 12 C.F.R. pt. 1005, app. A (adopting 12 C.F.R. pt. 205, app. A).

31. 15 U.S.C. § 1693m (2018); 12 C.F.R. §§ 1005.4(a)(1), 1005.17(d)(1) (2020).

and invited feedback on four draft alternative versions.[32] However, as of the date of this article, the CFPB has taken no further action and has provided no information regarding the alternative versions of Form A-9. In May 2019, pursuant to section 610 of the Regulatory Flexibility Act, the CFPB issued a request for comment on the "economic impact of the [o]verdraft [r]ule on small entities," but did not otherwise address replacing Form A-9.[33]

The consumer confusion created by the outdated Form A-9, the lack of regulatory guidance clarifying these discrepancies, and the statutory private rights of action from which consumers benefit for a financial institution's failure to provide proper notice, when taken together, created an environment ripe for judicial intervention. In a 2019 decision by the U.S. Court of Appeals for the Eleventh Circuit, *Tims v. LGE Community Credit Union*,[34] the tribunal addressed an issue of first impression for the federal appellate courts. The court held, consistent with the "great weight" of authority to have considered this issue at the federal district court level, that the EFTA safe harbor only insulates financial institutions from EFTA claims based on the *means* by which the institution has communicated its overdraft policy; the provision does not protect a financial institution from challenges to the substance of its opt-in agreement, even if the institution has used Form A-9 to describe its overdraft service.[35] In reaching its holding, the court rejected the defendant's argument that it provided adequate disclosures by providing language virtually identical to Form A-9. Instead, the court relied upon the dictionary definition of the term "form" (as used in the statute), reasoning that the safe harbor insulates financial institutions from EFTA claims based on the means used to communicate their overdraft policies, such

32. *See* Gregory Evans & Gary Stein, *Know Before You Owe: We Are Designing New Overdraft Disclosure Forms*, Consumer Fin. Prot. Bureau: Blog (Aug. 4, 2017), https://www.consumerfinance.gov/about-us/blog/know-you-owe-we-are-designing-new-overdraft-disclosure-forms/.

33. Consumer Fin. Prot. Bureau, Overdraft Rule Review Pursuant to the Regulatory Flexibility Act 1 (May 6, 2019), https://files.consumerfinance.gov/f/documents/cfpb_rfi_overdraft-rule.pdf.

34. 935 F.3d 1228, 1244–45 (11th Cir. 2019). In *Tims*, a customer (Tims) brought a class action against her credit union for violating the EFTA's rules against the assessment of overdraft fees. Tims' claim was principally based upon a ledger balance calculation method employed to assess two separate overdraft fees levied against her. Specifically, Tims claimed that the opt-in agreement notice provided little in respect of explaining which ledger balance calculation method would be used to assess whether an overdraft had occurred. *Id.* at 1236. LGE responded by arguing, among other things, that the information provided to Tims was sufficient given that it copied nearly verbatim the model form language to its disclosure form. *Id.* at 1244.

35. *Id.* at 1244-45; *see also* Salls v. Dig. Fed. Credit Union, 349 F. Supp. 3d 81, 91 (D. Mass. 2018) (["M]ost courts have interpreted the safe [harbor] provision as precluding liability for violations arising from the form notice takes but not from misleading or inaccurate content it includes."); Walbridge v. Ne. Credit Union, 299 F. Supp. 3d 338, 349 (D.N.H. 2018) ("With only one cited exception, the safe harbor provision has been interpreted to protect institutions from liability for violations arising from the form of notice provided but not from inaccurate or misleading content of the notice."); Gunter v. United Fed. Credit Union, No. 3:15-CV-00483, 2017 WL 4274196, at *3 (D. Nev. Sept. 25, 2017) (explaining that the defendant "may not rely on the second safe harbor provision because [plaintiff] does not allege that [defendant] failed to make disclosure in 'proper form'"); Berenson v. Nat'l Fin. Servs., LLC, 403 F. Supp. 2d 133, 151 (D. Mass. 2005) ("[T]he statutory language [of the safe harbor provision] suggests that this defense insulates an institution from a challenge as to the form—not the adequacy—of the disclosure.").

as how disclosures are presented and consent obtained, not against claims based on the adequacy of the disclosures.[36]

The holding in *Tims* seems directly contrary to the purpose of model language, which is to allow language vetted by regulators for understandability and accuracy to be provided consistently across financial institutions. In fact, it is likely that failure to use language substantially similar to that in Form A-9 would draw scrutiny from the institution's regulator and may be deemed inadequate for purposes of complying with the Opt-In Requirements in violation of the EFTA and Regulation E. Therefore, by not updating Form A-9 to expressly address or otherwise provide institutions flexibility to address industry changes affecting overdraft practices, the CFPB leaves financial institutions in an untenable position of choosing between mitigating the risk of potential private action under the EFTA or action by its regulator for non-compliance with the EFTA and Regulation E.

B. Error Resolution

Another section of Regulation E worthy of reexamination relates to error resolution associated with new payment mechanisms. Digital wallets and mobile payment applications, such as Venmo, Paypal, Apple Pay, and GooglePay, are gaining in popularity and may eventually replace traditional payment mechanisms. COVID-19, as with other forms of banking innovation mentioned in this article, will likely increase reliance on these digital technologies in order to protect members of the public from unnecessary germ exposure, including in connection with actions that are as basic as the use of cash, the keypads and pens on POS terminals, and ATM screens, among others. This new era of payments innovation, however, creates a gray area with respect to financial institutions' responsibilities and accompanying liabilities under Regulation E for unauthorized EFTs occurring through third-party digital wallet applications. Among other things, such ambiguity has created uncertainty for consumers regarding which financial institution should be contacted when unauthorized activity occurs on these applications.

Under Regulation E, an unauthorized EFT is defined as a transfer from a consumer's account initiated by someone other than the consumer, without actual authority to initiate the transfer, from which the consumer does not receive benefit.[37] Regulation E establishes parameters under which financial institutions must investigate and resolve claims of unauthorized EFTs, including those that occur on digital wallets, and assigns liability to a financial institution if it determines an EFT was actually unauthorized.[38] However, Regulation E carves out a narrowly defined set of circumstances in which liability shifts from an account-holding institution to a service provider that does not hold the consumer's account. In short, liability shifts to the service provider if three conditions are

36. *Tims*, 935 F.3d at 1245.
37. 12 C.F.R. § 1005.2(m) (2020).
38. *Id.* § 1005.11.

present.[39] First, the service provider must be providing an EFT service to the consumer.[40] Second, the service provider must issue a debit card (or other access device) that the consumer can use to access the consumer's account held by a financial institution.[41] An access device is defined as "a card, code, or other means of access to a consumer's account, or any combination thereof, that may be used by the consumer to initiate" EFTs.[42] Examples include "debit cards, personal identification numbers (PINs), telephone transfer and telephone bill payment codes, and other means that may be used by a consumer to initiate an [EFT] to or from a consumer account."[43] Finally, the service provider must not have an agreement with the account-holding institution regarding such access.[44] In instances where an unauthorized EFT occurs on a consumer's account and the access device used for that EFT was issued by the service provider without an agreement with the financial institution holding the account,[45] the service provider, and not the financial institution, is responsible for the investigation and resolution of the unauthorized transaction under the regulation.[46]

When applying this framework to unauthorized transactions that occur on third-party digital wallet platforms, however, it is not always immediately clear where liability lies. The lack of clarity stems primarily from uncertainty surrounding whether any given digital wallet issued by the third-party service provider constitutes an access device. Neither the CFPB nor any of the federal banking agencies ("FBAs") have issued definitive guidance regarding if and under what circumstances a digital wallet would meet the definition of an access device. While there may be an argument that digital wallets should generally be considered access devices—as digital wallets typically require some form of PIN or other code that allows an EFT to be initiated from a consumer's account—whether a given digital wallet platform would fit the definition hinges on its specific functionality.

For example, where a digital wallet is simply used to store debit card information, the digital wallet, by itself, cannot debit the consumer's deposit account; it can only access the debit card information that is actually used to make the debit. This type of digital wallet is functionally used as a pass-through to access the consumer's stored debit card information, not the deposit account. For this reason, it would likely fail to fit within the definition of a "means of access" to a consumer's account under Regulation E.[47] On the other hand, where a digital wallet allows consumers to link their checking accounts and bank routing

39. *See id.* § 1005.14(a).
40. *Id.*
41. *Id.* § 1005.14(a)(1).
42. *Id.* § 1005.2(a)(1).
43. *Id.* §§ 1005.2(a), pt. 1005, supp. I.
44. *Id.* § 1005.14(a)(2).
45. Compare digital wallets such as Apple Pay where the services always require agreements with the account-holding institution with wallets such as Venmo where no agreement is required at all: section 1005.14 would apply in the latter case only.
46. *Id.* § 1005.14(b)(2), (c).
47. *See id.* § 1005.2(a)(1).

numbers to the digital wallet in order to initiate EFTs—thereby allowing consumers to make ACH transfers directly to and from their deposit accounts without ever using debit card rails—a plausible argument that the wallet serves as an access device can be made.[48]

The CFPB has waded into this area by including in the definition of "prepaid account" certain digital wallets, such as those with a "staged" infrastructure, causing them to be covered by the Prepaid Rule.[49] Among other things, the Prepaid Rule includes error resolution requirements specific to prepaid accounts.[50] However, the Prepaid Rule does not resolve questions regarding error resolution for all digital wallets. That the CFPB initiated a roadmap to a useable approach, without fully addressing this gap, further underscores the need for the agency to amend Regulation E to clearly address responsibility for unauthorized EFTs that occur on digital wallets. Until the CFPB takes such action, however, financial institutions will be left to determine where to draw the line regarding responsibility for errors that occur through the use of digital wallets.

All of this underscores the need by the CFPB to update and clarify the scope of liability for account-holding institutions in connection with unauthorized EFTs that occur on digital wallets. Doing so will alleviate uncertainty both from an industry and consumer perspective by (i) allowing consumers to make informed decisions about the relative risks associated with engaging with third-party digital wallet providers, and (ii) giving account holding institutions the clarity required to implement policies to ensure compliance under the EFTA without taking error resolution responsibility that belongs to the digital wallet.

III. Brokered Deposits

The governing framework for brokered deposits—an area falling within the FDIC's scope of responsibility—has also outlived its utility, as laws created in a different era have been stretched by the nation's deposit insurance agency to cover an evolved state bearing little resemblance to the products originally within the framework's scope. The FDIC has recognized the need for modernization and is currently working to align its treatment of brokered deposits with the business realities of today's expanding array of innovative deposit products,

48. Further, before an account-holding institution determines it will attempt to shift liability for unauthorized EFTs made via ACH from digital wallets to the digital wallet provider, it must also consider, as a practical matter, that consumers who link their checking account directly to their digital wallets oftentimes also link the same digital wallet to their debit card. Because of this, the same digital wallet that may serve as an access device in one transaction may not be considered an access device in another, even though the EFTs are moving from the same deposit account. Whether the financial institution or the digital wallet provider is responsible for unauthorized EFTs under Regulation E, therefore, depends on analyzing not just how the wallets are set up, but how EFTs on any particular digital wallet transaction are initiated.

49. *See id.* pt. 1005, supp. I, cmt. 2(b)(3)(i)(6) (explaining that "if a product allows a consumer to transfer funds, which can be stored before the consumer designates a destination for the funds, the product" meets the definition of "prepaid account" in section 1005.2(b)(3)(i)(D)).

50. *See id.* § 1005.18(d)(1)(ii).

including arrangements driven by traditional depository institutions' partnerships with fintechs or other referral sources.

Brokered deposits are deposits made to a bank with the assistance of a third-party deposit broker.[51] Today, the term includes a diverse array of deposit placement arrangements, which include brokerage sweep accounts, traditional brokered certificates of deposit ("CDs"), prepaid card programs and health savings accounts, and a number of other online and mobile-based products.[52] Most of these placement arrangements are relatively new, however, and have only come into existence in the years since Congress first passed legislation creating restrictions on brokered deposits. Those restrictions, set out in section 29 of the Federal Deposit Insurance Act ("FDIA"), were enacted in 1989 in response to the savings-and-loan ("S&L") crisis of the 1980s, during which more than 1,000 deposit-taking institutions failed, costing taxpayers an estimated $124 billion.[53] The FDIA generally prohibits banks that are not well capitalized from accepting brokered deposits from a "deposit broker."[54]

In enacting the brokered deposit restrictions, Congress sought to address an entirely different set of brokered deposits, with meaningfully different characteristics than those in effect today.[55] And over time, many have commented that the FDIC's interpretation of the definition of "deposit broker" and its exclusions have been so broad that they reached beyond the scope of the banking practices the FDIA intended to address: restricting the facilitation of deposit gathering for misuse by troubled banks.[56] As a result, even well-capitalized institutions have been discouraged from innovating—including, more recently, entering into partnerships with emerging fintechs—because the deposits gathered could be labeled brokered deposits, forcing adoption of higher capital, increasing operating costs, and inviting regulatory scrutiny. This has impeded traditional banks as they have tried tapping into the innovative solutions being offered by fintechs, emerging companies developing cutting-edge products from accessing the reach and benefiting from the name recognition of established institutions, and ultimately, consumers taking advantage of opportunities to manage their finances in a more convenient way through remote platforms.

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51. *See id.* § 337.6(a)(2).

52. See Jelena McWilliams, Chairman, Fed. Deposit Ins. Corp., Statement at FDIC Board Meeting: Notice of Proposed Rulemaking on Revisions to the Brokered Deposits Regulations (Dec. 12, 2019), https://www.fdic.gov/news/news/speeches/spdec1119.html.

53. During the S&L crisis, certain deposit-taking institutions developed a pattern of shifting reliance from core deposits to brokered deposits and using the new liquidity to make risky loans, which eventually led to distress. The FDIC determined that increased reliance on brokered deposits correlated to greater probability and costs of failure. *See* Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, § 224, 103 Stat. 183, 273 (1989) (codified as amended at 12 U.S.C. § 1831f (2018)); *see also* Congressional Res. Serv., FDIC Proposes Change to Brokered Deposit Regulation (Jan. 6, 2020), https://crsreports.congress.gov/product/pdf/IN/IN11209.

54. *See* 12 U.S.C. § 1831f(g).

55. *See* McWilliams, Statement at FDIC Board Meeting, *supra* note 52.

56. *See, e.g.*, Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7453, 7455 (proposed Feb. 10, 2020) (to be codified at 12 C.F.R. pts. 303, 337) (explaining that "commenters indicated that the definition is unclear and has been interpreted too broadly, capturing many products or transactions that were not intended to be covered").

The FDIC sought to address these policy and interpretational limitation concerns by issuing a notice of proposed rulemaking ("NPR") in connection with planned revisions to its regulations relating to the brokered deposits restrictions that apply to less than well-capitalized insured depository institutions.[57] The proposed rule looks to restructure the analytical framework of these restrictions, and is intended to modernize the regulations to reflect recent technological changes and innovations that have occurred, such as changes in connection with how consumers use third-party fintechs to obtain access to banking.[58] Possessing sole statutory responsibility for implementing updates to the brokered deposit regulations permits the FDIC to operate with a flexibility that does not exist in other areas of banking law covered by multiple federal agencies. Congress's grant of authority in the governing law allows the FDIC to pursue a course free from the restraints of interagency negotiation and bypass delays caused by accommodating competing viewpoints and perspectives.

A chief issue to be addressed under the NPR is an interpretational hole in the FDIA: the statute does not explicitly define "brokered deposit." Instead, the act's implementing regulations interpret its meaning based upon the definition of "deposit broker." The FDIC regulations define "brokered deposit" as "any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker."[59] The efforts to modernize the framework, therefore, require, among other things, reinterpretation of the definition of "deposit broker." Currently, a deposit broker is defined by statute as a "person engaged in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions or the business of placing deposits with insured depository institutions for the purpose of selling interests in those deposits to third parties."[60]

The preamble to the proposed rule reflects an industry concern that the existing definition appears to depend on the involvement of any third party (including affiliates or subsidiaries of the bank) in sourcing the customer relationship or servicing the customer.[61] As a result, entities such as retailers, employers, technology platforms, advertising and marketing partners, and fintech partners may currently be classified as deposit brokers, even though their activities may only be incidentally linked to a deposit account. Under the proposal, key portions of the definition would be interpreted more narrowly, which would

57. *Id.* at 7453.

58. *Id.*; *see* Telis Demos, *Rule Change Could Help Tech Firms Advance Into Banking*, WALL ST. J. (Dec. 15, 2019), https://www.wsj.com/articles/rule-change-could-help-tech-firms-advance-into-banking-11576418400?ns=prod/accounts-wsj.

59. 12 C.F.R. § 337.6(a)(2) (2020).

60. 12 U.S.C. § 1831f(g)(1)(A) (2018). The term "deposit broker" also includes "an agent or trustee who establishes a deposit account to facilitate a business arrangement with an insured depository institution to use the proceeds of the account to fund a prearranged loan." 12 C.F.R. § 337.6(a)(5)(i)(B) (2020).

61. *See* Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. at 7455.

result in excluding many of these incidental classifications from the definition.[62] Despite the intention behind modifying the deposit broker definition, the proposed rule may still be general enough to ensnare potential bank partners, as the proposed language expanding on the "facilitation" prong may capture companies that take any of the actions described in the subparts of the prong, whether or not those activities would pose risks to the institutions or the deposit insurance fund.[63]

On June 15, 2020, U.S. Senator Jerry Moran (R-Kan.) attempted to circumvent the FDIC's proposed rulemaking by introducing a bill (S. 3962) to amend the FDIA's brokered deposits framework by removing and replacing all brokered deposits restrictions with "asset growth restrictions."[64] The bill received strong support from the American Bankers Association, which regarded it as "a much-needed measure to ensure that banks of all sizes have access to a stable and diverse funding base, and are able to innovate to meet the needs and expectations of their customers."[65] As of the date this article was written, the bill was referred to the Committee on Banking, Housing, and Urban Affairs for review, but further action had not been taken.[66]

The current brokered deposits restrictions have been in existence for thirty years and, like many other rules enacted to regulate financial products, these restrictions have seen their efficacy wane as a result of significant financial and marketplace innovation. The FDIC's approach in seeking to modernize these restrictions through the proposed rule has demonstrated an awareness of the practical limitations to the current brokered deposit regulatory framework and a desire to prioritize reform. Its explicit consideration of the emergence of bank-fintech collaboration is notable when contrasted with other regulators' more mixed results in corralling the emerging fintech industry.[67] While industry comments to the proposed rule show that the FDIC's changes may not go far enough to fully address the impact on lifting restrictions applicable to an expanding array of

62. Another area receiving significant attention under the proposal is the primary purpose exception. The primary purpose exception applies to "an agent or nominee whose primary purpose is not the placement of funds with depository institutions." 12 C.F.R. § 337.6(a)(5)(ii)(I) (2020). Persons meeting this definition are excluded from the definition of "deposit broker" and any deposits that it places with insured depository institutions are brokered deposits. *See id.* Under the proposal, however, the FDIC proposes that the primary purpose exception application be based on whether the primary purpose of the agent's business relationship with its customers is not the placement of funds with depository institutions. The proposed rule, which sets forth three tests to determine whether the exception is met, would result in expanding the number of entities that meet the exception. *See* Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. at 7458–59.

63. *See* Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. at 7472 (setting out the proposed activities that would cause an entity to "engage[] in the business of facilitating the placement of deposits . . . with insured institutions").

64. *See* Asset Growth Restriction Act of 2020, S. 3962, 116th Cong. (2020).

65. James C. Ballentine, *ABA Letter to the Senate: Support S. 3962*, Am. Bankers Ass'n (June 16, 2020), https://www.aba.com/advocacy/policy-analysis/aba-letter-to-the-senate-support-3962#_ga=2.76830800.453117121.1593103345-690892440.1588989132.

66. *See S.3962—Asset Growth Restriction Act of 2020, Actions Overview*, Congress.gov, https://www.congress.gov/bill/116th-congress/senate-bill/3962/titles?r=2&s=1 (last visited July 14, 2020).

67. Unsafe and Unsound Banking Practices: Brokered Deposits Restrictions, 85 Fed. Reg. at 7455.

deposit product offerings, the road to modernization for brokered deposits appears to be moving forward through the FDIC's proposed rule. However, such forward momentum may be in jeopardy if S. 3962 gains traction, as the FDIC may find itself back at square one promulgating a new set of rules in response to an amended FDIA.

IV. Bank Secrecy Act/Anti-Money Laundering

The U.S. federal anti-money laundering ("AML") regime—anchored by the Bank Secrecy Act ("BSA") and its implementing regulations—is an area ripe for regulatory reform in light of recent innovation. The BSA was enacted in 1970, and its original focus was on organized crime.[68] In the 1980s and 1990s, its focus shifted to narcotics trafficking and, following passage of the USA PATRIOT Act in 2001, the BSA became a primary weapon in the war on terror. Its scope has since been expanded to cover a host of other illicit activities, including cyberfraud, human trafficking, and elder abuse. The BSA now applies to a broad range of nonbank financial institutions, such as money transmitters, residential mortgage loan originators, and dealers in precious metals.[69] Initial recordkeeping and reporting obligations have also broadened significantly. The Financial Crimes Enforcement Network ("FinCEN"), a bureau of the Treasury Department, serves as the primary regulator responsible for implementing and enforcing the BSA, in partnership and coordination with the federal banking agencies, securities regulators, and the IRS.[70]

Virtually all of the changes to the BSA since its enactment have been additive; successive legislation ushered in major structural changes to the law's scope, and FinCEN, along with its partner regulators, have implemented those changes through new regulations. Although the scope and breadth of this regime have expanded in recent years, the remnants of the initial framework remain in place. There is widespread and growing consensus within the financial services industry, the regulatory community, and Congress for BSA reform, but little has actually been done to modernize the structure on a holistic level.[71] Given the vastly different operational and technological platforms employed by banks and nonbanks today, the BSA's legacy requirements should be modernized to better support the evolved objectives of the BSA and the realities of internet-age banking. The regulators responsible for enforcing the federal AML regime can try to modernize this framework using different tools available in the regulatory toolbox absent legislative or regulatory overhaul and, as the examples below illustrate, have employed some of these approaches in recent years.

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68. Bank Secrecy Act, Pub. L. No. 91-508, 84 Stat. 1114 (1970) (codified as amended in scattered sections of 12, 15 & 31 U.S.C.).

69. *See, e.g.*, 31 C.F.R. pts. 1022, 1027 & 1029 (2020).

70. *See id.* § 1010.810.

71. For example, the past few Congresses have formulated various bills designed to update aspects of the BSA framework but, as of the date of this writing, no major BSA reform bill has been passed by both houses. *See, e.g.*, Coordinating Oversight, Upgrading and Innovating Technology, and Examiner Reform Act of 2019, H.R. 2514, 116th Cong. (2019).

A. Customer Identification Program Rule

FinCEN, the federal banking agencies, and functional regulators jointly issued the Customer Identification Program ("CIP") Rule in 2003.[72] The CIP Rule requires banks and a subset of other covered financial institutions to obtain four core pieces of information from their customers at the time of account opening: the customer's name, address, date of birth, and an identification number.[73] The CIP Rule further requires that covered institutions verify customers' identity using either documentary or non-documentary methods.[74] Back in 2003, internet banking was in its infancy, mobile banking did not exist, and most bank accounts were opened through face-to-face transactions in branches; digital collection was non-existent.

In contrast, credit card accounts typically were not opened in face-to-face transactions. In 2003, most credit card accounts were opened over the telephone. During the CIP Rule's comment period, the credit card industry pushed for a carve-out from the requirement to obtain customers' identifying information directly. As a result, an exception was written into the final rule permitting institutions opening credit card accounts to obtain this information from a third-party source.[75] The credit card exception reflected regulators' willingness to waive certain requirements based on business realities.[76]

Today, most bank accounts are opened over the internet and via mobile banking.[77] With identity theft and data breaches constantly making headlines, consumers understandably are reluctant to provide core identifying information online—particularly the identification number, which is often a Social Security number. Technological advancements since 2003 have created many new ways to collect and verify a customer's identity beyond obtaining these four pieces of information. For example, independent databases can provide an individual's address, phone number, and email address after entering the customer's name. Out of wallet systems can verify a customer's identity by asking personal questions confirming the user's knowledge of this core information, without requiring manual entry into a system. Digital and biometric identification technologies have expanded and can also play a similar role. Each of these modern alternatives can substitute for the more tedious and costly efforts of obtaining the information directly from customers and, as often is the case, checking documentary customer

72. Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. 25090 (May 9, 2003) (to be codified at 31 C.F.R. pts. 1020–1030).

73. *See, e.g.*, 31 C.F.R. § 1020.220(a)(2)(i)(A) (2020).

74. *See, e.g.*, *id.* § 1020.220(a)(2)(ii).

75. *See id.* § 1020.220(a)(2)(i)(C).

76. *See* Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks, 68 Fed. Reg. at 25097.

77. *See, e.g.*, Al Pascual et al., Looking Beyond KBA: Solving the Fraud vs. Customer Experience Challenge in Digital Account Opening 6 (Nov. 21, 2016). More generally, a recent survey conducted by *Business Insider Intelligence* found that 89 percent of respondents said they used mobile banking. *See* Andrew Meola, *The Digital Trends Disrupting the Banking Industry in 2019*, Bus. Insider (Aug. 8, 2019), https://www.businessinsider.com/banking-industry-trends. A lesser proportion of accounts are still opened over the phone.

ID, such as a license or passport, to verify that identity. These alternatives should still satisfy the ultimate objective of the CIP Rule: enabling the institution to "form a reasonable belief that it knows the true identity of each customer."[78] In the face of the COVID-19 pandemic, the reliance on mobile banking has only intensified, driven not just by consumer desire for convenience, but by necessity due to social distancing mandates, state orders closing physical business locations, and a general avoidance of personal contact due to health concerns.

Notwithstanding the pace of technological advancement and changes in the way that financial products are delivered, the CIP Rule requires that for non-credit card accounts, the information must be obtained "from the customer prior to opening an account."[79] These problems have only been compounded by the issuance of FinCEN's Customer Due Diligence ("CDD") Rule in 2016,[80] which more or less uncritically adopted the CIP Rule's requirements and applied them to the identification and verification processes for covered customers' beneficial owners.[81] To account for the realities of modern banking and the dangers posed by providing sensitive data through digital channels, FinCEN and the federal banking agencies should revise their regulations to remove the direct collection requirement—in other words, to expand the credit card exception to all accounts. The agencies could further provide covered institutions with a greater ability to rely on non-documentary methods of verification, such as comparison to information from a consumer reporting agency, public database, or other institutions' records.

The process for FinCEN to formally amend the CIP Rule and its CDD Rule counterparts through notice and comment, however, would be burdensome and laborious. FinCEN and the federal banking agencies could instead grant exceptive relief from the "direct" aspects of these rules, acknowledging the prevalence of digital banking in the space. FinCEN has evidenced a willingness to grant exceptive relief under its statutory and regulatory authorities[82] from certain requirements of the CDD Rule, including identification and verification obligations for beneficial owners.[83] On September 7, 2018, FinCEN granted exceptive relief from these requirements when legal entity customers open a new account

78. *See, e.g.*, 31 C.F.R. § 1020.220(a)(2) (2020). In March 2020, the Financial Action Task Force ("FATF") released guidance on identifying and verifying customers' identities in the digital ID context. *See Guidance on Digital Identity*, FATF (Mar. 2020), https://www.fatf-gafi.org/publications/fatfrecommendations/documents/digital-identity-guidance.html.

79. *See* 31 C.F.R. § 1020.220(a)(2)(i)(A).

80. *See* Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29398 (May 11, 2016) (to be codified at 31 C.F.R. pts. 1010, 1020, 1023, 1024 & 1026).

81. *See generally* 31 C.F.R. § 1010.230 (2020).

82. *See* 31 U.S.C. § 5318(a)(7); 31 C.F.R. § 1010.970(a) (2020).

83. To date, the agencies have issued one exemption to the CIP Rule, exempting insurance premium financing in 2018. *See* Bd. of Governors of the Fed. Reserve Sys. et al., Order Granting an Exemption from Customer Identification Program Requirements Implementing Section 326 of the USA PATRIOT Act, 31 U.S.C. § 5318(l), for Loans Extended by Banks (and Their Subsidiaries) Subject to the Jurisdiction of the Federal Banking Agencies to Commercial Customers to Facilitate Purchases of Property and Casualty Insurance Policies (2018), https://www.occ.gov/news-issuances/bulletins/2018/bulletin-201-35a.pdf.

as a result of a rollover of a CD, or a renewal, modification, or extension of a loan, among other activities.[84] In the ruling, FinCEN stated that it had consulted with financial institutions, trade associations, regulators, and law enforcement regarding these requirements.[85] The consultations influenced the agency's assessment of the money laundering risks posed by these products and led to a re-evaluation of the "practical impact" the Rule had.[86] As a result, FinCEN effectively modified the governing regulatory regime to reduce compliance costs and account for business realities. Pursuing targeted rulings granting exceptive relief therefore appears to be a workable alternative to address the CIP and CDD Rule burdens described above, and one that has a measure of acceptance from the agencies overseeing compliance with those requirements.

More recently, FinCEN, in conjunction with the Office of the Comptroller of the Currency ("OCC") and Small Business Administration ("SBA"), issued a series of guidance documents providing some maneuverability to covered financial institutions disbursing loans through the Paycheck Protection Program ("PPP") established by the Coronavirus Aid, Relief and Economic Security Act ("CARES Act").[87] These FAQs clarified application of the CDD Rule to PPP loans and granted some leeway from the technical strictures of the Rule when institutions sought to verify the identifying information for existing and new customers seeking loans under the program.[88] As with many other areas of banking regulation, the COVID-19 pandemic has exposed potential financial impacts from outdated regulation, as lenders may delay provision of funds to cash-starved businesses while relying on outdated, albeit accepted, means of customer verification. Fear of non-compliance with technical regulatory requirements in an area as important as the BSA may also impact institutions' speed in addressing the needs of small businesses reeling from the pandemic, frustrating the objectives of the legislation. FinCEN and the OCC's actions to get out in front of these issues through public FAQs evidences a willingness to adapt regulations to ongoing needs of the industry and may set a course for future agency behavior.

B. Transaction Monitoring

One of the core objectives of the BSA is the facilitation of law enforcement investigations with information derived from the vast amount of data processed by financial institutions. This objective is accomplished primarily though institutions' filing of suspicious activity reports ("SARs"). SAR information assists a variety of federal and state agencies as they pursue a range of illicit financial

84. *See* FinCEN, FIN-2018-R0004: Exceptive Relief from Beneficial Ownership Requirements for Legal Entity Customers of Rollovers, Renewals, Modifications, and Extensions of Certain Accounts 1 (Sept. 7, 2018).

85. *Id.* at 2.

86. *Id.* at 2–3.

87. *See* Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, § 1102, 134 Stat. 281, 286 (2020).

88. *See* FinCEN, Paycheck Protection Program Frequently Asked Questions (as of Apr. 13, 2020), https://www.fincen.gov/sites/default/files/2020-04/Paycheck_Protection_Program_FAQs.pdf.

conduct; SAR narratives, dates, and names can connect dots or fill holes with data not available from other sources. SAR regulations permit institutions thirty calendar days to file a SAR after the "date of initial detection . . . of facts that may constitute a basis for filing."[89] If no suspect was identified, the bank may delay filing for an additional thirty calendar days to identify a suspect, but the regulations do not permit filing more than sixty calendar days after a "reportable transaction" has been identified.[90] Designed to hew to the regulation's timeframes, institutions' transaction monitoring systems have proven cumbersome and slow, and do not reflect technological advancements made after these regulations were issued in a pre-digital age. Rather than evolve, these unwieldy systems have persisted, bloating compliance costs without a recognizable net effect in advancing law enforcement's objectives.

Transaction monitoring systems producing the initial alerts are rules-based: institutions design and program scenarios—i.e., the "rules"—into their compliance frameworks based on a variety of unique, company-specific factors, such as customer base, geography, and product type. Spliced into that medley are known typologies of money laundering and terrorist financing, designed to help the system recognize known patterns of illicit behavior. When the rules are broken by transactions, an alert is generated and placed into a log to be cleared, more often than not, by human intervention. Institutions report that approximately 95 percent or more of generated alerts are false positives: despite the rules being tripped, no reportable suspicious activity occurred.[91] Institutions misallocate vast resources in clearing the backlogs of these false positives, and financial regulators have seized upon institutions' failure to keep pace with the alert volume to criticize the adequacy of lagging compliance programs.

The use of machine-based learning such as artificial intelligence ("AI") to replace rules-based transaction monitoring presents an opportunity to reduce compliance resource expenditures and provide relevant information to law enforcement in a more timely fashion. AI could pinpoint suspicious transactions occurring within the organization with greater precision, because it would interpret actual account activity, rather than relying on generic thresholds as a trigger for internal investigation. Notwithstanding that current AI needs further refinement before replacing current systems, AI may not fit neatly into the SAR regulations' timeframes, but those timeframes are relics of tracking and monitoring approaches designed in a far less digitized environment.

Recent efforts to provide regulatory sandboxes to experiment with new technology, including AI, is encouraging in this respect. In December 2018, FinCEN and the federal banking agencies issued a joint statement encouraging banks to consider and "responsibly implement" any "innovative approaches" to meet their

89. 31 C.F.R. § 1020.320(b)(3) (2020).

90. *Id.*

91. *See* Joshua Fruth, *Anti-Money Laundering Controls Failing to Detect Terrorists, Cartels, and Sanctioned States*, Reuters (Mar. 14, 2018), https://www.reuters.com/article/bc-finreg-laundering-detecting/anti-money-laundering-controls-failing-to-detect-terrorists-cartels-and-sanctioned-states-idUSKCN1GP2NV.

BSA/AML obligations.[92] The joint statement recognized that innovation had the potential to augment, as particularly relevant here, transaction monitoring and suspicious activity monitoring, while cautioning that banks should "prudently evaluate" at what point new approaches can be considered "sufficiently developed" to supplement or even replace their existing BSA/AML compliance controls and processes.[93] Shortly thereafter, FinCEN implemented an Innovation Initiative, which includes an Innovation Hours Program designed to provide an opportunity to showcase products, services, or approaches to AML compliance to FinCEN.[94] The OCC in particular reiterated its encouragement to its regulated entities to continue to responsibly implement innovative approaches to meet their BSA obligations in a bulletin issued in the midst of the COVID-19 crisis.[95]

Replacement of transaction monitoring systems in particular would require significant buy-in from the regulatory agencies, which have gained familiarity with the setup, operation, and output from the current systems. Acknowledging that revision of the SAR filing timelines would be a significant challenge, FinCEN's Innovation Initiative—and similar initiatives at the federal banking agencies—could provide a gateway for regulatory acceptance of AI use in transaction monitoring that may have been blocked only a few years ago by more rigid approaches from exam teams.[96]

C. Virtual Currency

Virtual currencies have garnered major headlines in recent years as prices fluctuate, investors gravitate, and scandals swirl. Gradually, financial regulatory agencies across the federal government have brainstormed on how to exercise jurisdiction over them. To date, the consensus approach appears to be a deliberate choice to shoehorn virtual currencies into existing regulatory frameworks set up for other products, services, or entities. For example, FinCEN—recognizing

92. *See* Bd. of Governors of the Fed. Reserve Sys. et al., Joint Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing 1 (Dec. 3, 2018).

93. *Id.* at 1–2.

94. FinCEN's website encourages companies to show up at the open times or request a meeting. *See FinCEN's Innovation Hours Program*, FinCEN, https://www.fincen.gov/resources/fincens-innovation-hours-program (last visited July 14, 2020).

95. *See* OCC Bulletin 2020-34, Bank Secrecy Act/Anti-Money Laundering: OCC Supports FinCEN's Regulatory Relief and Risk-Based Approach for Financial Institution Compliance in Response to COVID-19 (Apr. 7, 2020), https://www.occ.gov/news-issuances/bulletins/2020/bulletin-2020-34.html#5.

96. On June 4, 2020, the OCC released an Advance Notice of Proposed Rulemaking ("ANPR") seeking public comment on the OCC's rules on national banks' and federal savings associations' digital activities. *See* Office of the Comptroller of the Currency, National Bank and Federal Savings Association Digital Activities (June 4, 2020), https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-76a.pdf. Of particular relevance here, the OCC invited input on how AI techniques, including machine learning, could be used in transaction monitoring. *See id.* at 12. The agency also sought comment as to ways the banking industry could be using AI, but is not due to issues such as "regulatory complexity, lack of transparency, audit and audit trail complexities, or other regulatory barriers." *Id.* The ANPR floated the idea of the OCC providing regulatory guidance on the use of AI, including through issuance of regulations. *See id.*

the substantial money laundering and illicit finance risks posed—forced this new technology into regulatory provisions that govern money transmitters,[97] though the two concepts are not truly cut from the same cloth. The SEC and the CFTC have similarly tried to gain a foothold in regulating virtual currencies by treating initial coin offerings ("ICOs") as securities,[98] though this approach is also not the cleanest fit. Neither these agencies nor other federal agencies have, to date, erected new regulatory frameworks to govern virtual currencies. It is clear already that agencies' treatment of these emerging technologies within existing concepts and definitions, in order to facilitate a more immediate goal of obtaining a legal hook for regulation, has presented, and will continue to present, difficulties, absent implementation of a specialized, tailored framework under the umbrella of the BSA.

Numerous other examples abound where the BSA's framework and even its most recently implemented regulations have failed to keep pace with the evolution of technology. A comprehensive overhaul, designed to eliminate outdated standards and requirements, and implement focused and targeted regulations for new entity types and technologies, is necessary to provide clarity to covered institutions, take full advantage of emerging technology and innovation, reduce costs and burdens on the industry, and, most importantly, assist law enforcement. In the absence of formal legislative or regulatory changes—which are few and far between in the BSA/AML space—entities will likely need to turn to a smattering of exceptive relief rulings, guidance, and innovation initiatives to achieve these goals in the near term.

V. Community Reinvestment Act

For years, industry professionals have called for change to the Community Reinvestment Act ("CRA"), with the need for modernization becoming more apparent in view of the evolution of the banking landscape. Now more than forty years old, the CRA requires every federally insured bank and thrift institution that grants credit to the public to meet the credit needs of the communities they serve, including low- and moderate-income ("LMI") neighborhoods, consistent with safe and sound banking practices.[99] The CRA is premised on a fundamental recognition that communities require both credit and deposit services, and it obligates banks on a continuing basis to help meet the needs of those communities where they are chartered.[100] The statute has been a critical tool

97. *See* FinCEN, FIN-2013-G001: Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies (Mar. 18, 2013), https://www.fincen.gov/sites/default/files/shared/FIN-2013-G001.pdf.

98. *See* Jay Clayton & J. Christopher Giancarlo, Opinion, *Regulators Are Looking at Cryptocurrency*, Wall St. J. (Jan. 24, 2018), https://www.wsj.com/articles/regulators-are-looking-at-cryptocurrency-1516836363?mg=prod/com-wsj.

99. Community Reinvestment Act of 1977 § 804, 12 U.S.C. § 2903(a)(1) (2018).

100. *Id.* § 801, 12 U.S.C. § 2901 (2018).

for encouraging investments and promoting economic development in LMI communities.[101]

Much has changed since the CRA's enactment, including technology-driven innovations in financial services, which have rendered the CRA out of date in some ways. Consequently, the CRA's effectiveness in facilitating its mission has been minimized. Fortunately, the FBAs also recognize the need to modernize the CRA and have made efforts to move such modernization forward, although not necessarily through a concerted effort.

A. Changing Times

The CRA was enacted in 1977 as a legislative response to concerns that the financial services industry was engaging in geographic "redlining" and discrimination in the mortgage market.[102] The CRA aimed to incentivize banks to be more actively involved with lending in their local communities than they had in the past[103] through periodic federal examinations designed to assess banks based on their compliance with the law's standards in predetermined "assessment areas."[104] The geographic assessment area serves as the foundation upon which the CRA functions, comprising the geographic zones surrounding each of a bank's physical locations, which include its branches, its main office, and deposit-taking ATMs.[105] This framework reflects the historical roots of the CRA, which was enacted at a time when banks were primarily funded through deposits gathered from the local communities living in proximity to their branches.

In the forty years following the CRA's enactment, however, transformative changes have taken place in the banking industry that have rendered the current brick-and-mortar assessment strategy an increasingly outdated and poor barometer for the level of a bank's engagement with the communities from which it accepts deposits. For example, the proliferation of internet-based branchless banking has resulted in banks being domiciled in one geographic area, oftentimes with just one physical location, while gathering deposits nationwide. Branchless banks now hold $1.5 trillion in domestic assets, a number poised

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101. *See* Arjun Kaushal & David Mitchell, *The Community Reinvestment Act and the Future of Financial Inclusion*, Aspen Inst. (Jan. 15, 2019), https://www.aspeninstitute.org/blog-posts/the-community-reinvestment-act-and-the-future-of-financial-inclusion/ ("The CRA is credited with pumping nearly $2 trillion into historically underserved communities through mortgage, small business, and farm lending.").

102. Jonathan P. Tomes, *The "Community" in the Community Reinvestment Act: A Term in Search of a Definition*, 10 Ann. Rev. Banking L. 225, 226 (1991).

103. *See* Brooke A. Overby, *Community Reinvestment Act Reconsidered*, 143 U. Pa. L. Rev. 1431, 1456–57 (1995).

104. The CRA's regulatory framework underwent its most significant changes to date in 1995, when the FBAs shifted the focus away from process-oriented evaluation to performance-based metrics. *See* Community Reinvestment Act Regulations, 60 Fed. Reg. 22156, 22156 (May 4, 1995) (to be codified at 12 C.F.R. pts. 25, 203, 228, 345 & 563e).

105. Ben Horowitz, *Defining "Low- and Moderate-Income" and "Assessment Area,"* Fed. Reserve Bank Minneapolis (Mar. 8, 2018), https://www.minneapolisfed.org/article/2018/defining-low–and-moderate-income-and-assessment-areas.

to increase significantly as digital banking continues to drive sector growth.[106] Despite this, a critical statute designed to drive engagement in community development activities is fundamentally misaligned with how they do business.

In addition, technological advances in the retail banking industry overall, such as online banking, mobile account accessibility, remote deposit capture, and twenty-four-hour internet banking kiosks, have reduced reliance on brick-and-mortar branches for many tasks that can now be completed using a mobile device. These practices have in part fueled an 11.5 percent net reduction in the number of bank branches operating in the United States since 2010.[107] Moreover, this trend has been exacerbated, at least at present, by COVID-19, as thousands of bank branches have been temporarily closed during the pandemic with many more only providing restricted access.[108] This has resulted in consumers facing increased challenges in accessing their money through traditional branch channels during the COVID-19 pandemic, forcing even more consumers into the digital banking fold. This influx will not only illuminate the consumer appetite for the tools offered through digital banking channels, but it will also shine a light on the banking industry's bandwidth as a whole to handle such a massive surge in volume.[109] While only time will tell the true story, the trend toward digital banking that has been accelerated by COVID-19 will likely continue to reduce reliance on traditional branches and may eventually lead to a seismic shift in the way consumers bank in the years to come.

B. Modernization

In 2014, the OCC, FRB, and FDIC commenced modernization efforts through a review to identify "outdated, unnecessary, or unduly burdensome regulations."[110] The review culminated in a report submitted to Congress in 2017 identifying areas of improvement to the CRA regulatory framework based upon the regulators' observations and feedback from the public.[111] Today, each of the FBAs has stated that CRA modernization is a key priority; each agency, in its own right, has taken steps in that regard.

106. Jim Saksa, *Rise of Fintech Weakens Law to Prevent Lending Discrimination*, Roll Call (Oct. 15, 2019), https://www.rollcall.com/2019/10/15/rise-of-fintech-weakens-law-to-prevent-lending-discrimination/; Buzz Roberts, *Three Keys to CRA Modernization*, Novogradac (Feb. 4, 2019), https://naahl.org/wp-content/uploads/2019/02/Novogradac-Three-Keys-to-CRA-Modernization.pdf.

107. *See* Saksa, *supra* note 106.

108. Gregory Magana, *Several Major US Banks Are Closing Branches or Restricting Access as the Coronavirus Pandemic Worsens*, Bus. Insider (Mar. 23, 2020), https://www.businessinsider.com/us-banks-reassess-branch-strategy-amid-coronavirus-2020-3.

109. *See id.*

110. Community Reinvestment Act Regulations, 85 Fed. Reg. 1204, 1205 n.12 (proposed Jan. 9, 2020) ("The review is required by section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, Public Law 104–208, 110 Stat. 3009, 3311 (1996), *codified at* 12 U.S.C. 3311 (1996)." (emphasis in original)).

111. *Id.* at 1205–06 (explaining that among the most frequently raised issues were the definition of "assessment area"; incentives for banks to serve LMI, unbanked, underbanked, and rural communities; and refinement of the CRA ratings methodology).

On January 9, 2020, the OCC and FDIC jointly issued an NPR to update the regulatory framework implementing the CRA.[112] Despite the FBAs' nearly uniform lockstep approach since issuing the first set of implementing regulations under the CRA in 1978, it is notable that the FRB did not join the NPR.[113] Even more notable, and perhaps extremely surprising to many in the industry, the OCC moved forward without the FDIC, announcing its long-awaited final rule exactly six weeks after the comment period on the NPR closed.[114] The FDIC declined to join in promulgating the final rule, citing the burden on banks responding to COVID-19.[115] While the FDIC may ultimately decide to sign on to the final rule at a later time, the OCC's decision to unilaterally move forward with changes that affect only some, but not all, federally regulated institutions could result in banks having to navigate different sets of rules depending on who regulates them, potentially creating competitive inequities while perpetuating confusion and inconsistency.[116]

The final rule tackles CRA modernization in a number of critical ways. These include: (i) revising the assessment area framework; (ii) expanding and clarifying the criteria for the types of activities that qualify for CRA credit; (iii) providing a more transparent and objective method for evaluating CRA performance; and (iv) revising the recordkeeping, data collection, and reporting requirements.[117] Many of the rules promulgated under the final rule appear to directly respond to the myriad changes to the banking landscape. None of the revisions, however, are more critical than those addressing the banking innovation that will most significantly impact the current CRA's assessment framework: innovation causing banking to move beyond the branch network.

In promulgating the final rule, the OCC acknowledged that while brick-and-mortar facilities still play an important role in terms of the volume of deposits received from the communities they service, the current system does not contemplate the banking industry's dwindling reliance on branches overall.[118] This gap has resulted in, among other things, geographies that have very limited

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112. *Id.* at 1204.

113. The FRB has expressed its view that the approach advanced by the OCC and FDIC under the proposed rule deviates dramatically from the core purpose of the CRA and does not further the goal at the heart of the statute. *See* Lael Brainard, Governor, Bd. of Governors of the Fed. Reserve Sys., Strengthening the Community Reinvestment Act by Staying True to Its Core Purpose, Address at the Urban Institute, Washington, D.C. (Jan. 8, 2020), https://www.federalreserve.gov/newsevents/speech/brainard20200108a.htm; *see also* Martin J. Gruenberg, Member, Fed. Deposit Ins. Corp. Bd. of Dirs., Statement on the Notice of Proposed Rulemaking: Community Reinvestment Act Regulations 1 (Dec. 12, 2019), https://www.fdic.gov/news/speeches/spdec1219d.pdf (explaining that the revisions proposed by the OCC and FDIC are "deeply misconceived" and would "fundamentally undermine and weaken" the CRA).

114. Community Reinvestment Act Regulations, 85 Fed. Reg. 34734 (June 5, 2020) (to be codified at 12 C.F.R. pts. 25 & 195) [hereinafter Final Rule].

115. *See* Jelena McWilliams, Chairman, Fed. Deposit Ins. Corp., Statement on the CRA Joint Proposed Rulemaking (May 20, 2020), https://www.fdic.gov/news/news/speeches/spmay2020.html.

116. *See* Nat'l Cmty. Reinvestment Coal., Letter to Regulators on CRA Regulatory Actions (Sept. 9, 2019), https://ncrc.org/letter-to-regulators-on-cra-regulatory-actions/.

117. *See* Final Rule, *supra* note 114, at 34734.

118. *See id.* at 34756.

to no bank engagement, referred to as "CRA deserts."[119] To address these issues, the OCC began by making the policy determination that, in addition to being required to meet the needs of the communities in which they have branches, banks should also be required to meet the needs of communities from which they receive deposits and where their customers are located.[120]

Building upon this policy determination, the final rule amends the current framework by expanding the areas in which CRA activity counts. The final rule retains the brick-and-mortar-based, or "facility-based," assessment area delineation requirement;[121] however, in addition, the final rule adopts a "deposit-based" assessment area delineation requirement, which requires banks that receive at least 50 percent of their domestic deposits from outside their "facility-based" assessment areas to also delineate deposit-based assessment areas for areas comprising at least 5 percent of their retail domestic deposits.[122] The final rule clarified that the 50 percent threshold was set with the future in mind, as the banking industry continues to evolve and its reliance on traditional bank branches continues to decrease.[123] Moreover, in lieu of creating more complicated definitions to fit non-traditional business models, the OCC chose the 50 percent deposit-based assessment threshold as a straightforward way to address large compliance gaps created by banking innovation over recent years.[124] This threshold provides a framework that better attaches CRA obligations to the fintech business model, such as those involving branchless banks that may have a single office in an out-of-the-way location or banks that may only conduct a small fraction of their business near their office, while receiving deposits and making the vast majority of their loans in distant areas.

When first proposed, the deposit-based assessment requirement was met with concern that the new framework would steer CRA responsibilities to population centers (or "CRA hotspots") that are already well served (e.g., New York City, Chicago, Los Angeles), and do little to help with the growing problem of CRA deserts, as those communities would be the least likely geographies to have enough deposit activity to reach the 5 percent threshold. The final rule responded to these concerns in two ways. First, the final rule negates the CRA hotspots issue because deposit-based assessment areas must be in areas of the country outside of a bank's facility-based assessment area.[125] Population centers contain a high concentration of bank branches, so they are unlikely to count toward the

119. The final rule adopts a definition of "CRA desert" as an area with "significant unmet CD or retail lending needs and where: (1) few banks have branches or non-branch deposit-taking facilities; (2) there is less retail or CD lending than would be expected based on demographic or other factors; or (3) the area lacks community development organizations or infrastructure." *Id.* at 34748.

120. *Id.* at 34756.

121. *See id.* While the final rule generally keeps the facility-based model intact, it eliminates the requirement that banks delineate assessment areas in areas in which a bank's "deposit-taking ATM is the only means by which the bank is drawing deposits" if the aggregate deposits in the area are 2.5 percent or less of the bank's total retail deposits. *Id.* at 34757.

122. *Id.*

123. *See id.* at 34758.

124. *See id.*

125. *See id.*

50 percent deposit-based assessment threshold.[126] Second, and perhaps more significantly, under the final rule, a bank would be permitted to delineate its deposit-based assessment area "at any geographical level up to the state level."[127] This modification allows a bank to aggregate deposits from a much larger geographic area to reach the 5 percent threshold, thereby further incentivizing banks to engage in CRA qualifying activities in these areas.[128]

All in all, confronted with the need to modernize, the OCC's decision to break from tradition by unilaterally issuing its own standard for examination and evaluation could have meaningful consequences for banks across the country as they continue to incorporate technological advances into their businesses. However, if the CRA is to continue to carry out its mission of extending access to lending to the communities that need it the most, then modernization is vitally important and must be adopted, in some form, by all FBAs. The OCC has taken the initiative to move the modernization effort forward; the burden has now shifted to the FDIC and FRB to respond.

VI. Conclusion

As the examples in this article evidence, efforts to modernize various aspects of the regulatory framework governing the U.S. financial services industry are desperately needed, but beset by a number of distinct obstacles that federal agencies have tackled with various degrees of effectiveness. When faced with a national crisis, such as COVID-19, the FRB was able to move quickly to revise Regulation D to remove outdated requirements and provide much needed transactional flexibility to depository institution customers. Similarly, with its ability to work alone, the FDIC's efforts to update its laws regarding brokered deposits may also result in an efficient modernization response, assuming Congress does not send the FDIC back to the start by amending the FDIA.

In other areas, however, it seems that modernization will not come as quickly or easily. Facing a multitude of outdated compliance burdens that linger in the BSA's structure, FinCEN and its regulatory counterparts have attempted to release participants from their obligations through exceptive relief and encouragement of innovation, but these efforts are narrowly tailored and may face headwinds from examiners in the field. While the CFPB has made some efforts to modernize portions of Regulation E, significantly more work is needed to ensure requirements are clear and responsibilities are properly aligned in response to current industry practices and ever-changing technologies. Finally, despite the onerous nature of the administrative rulemaking process and the glare of the public spotlight, the FDIC and OCC embarked on this course to address longstanding issues plaguing

126. *See id.*

127. *Id.* at 34757.

128. Moreover, the OCC acknowledged that the new assessment model alone does not cure the problem of CRA deserts. However, instead of making further revisions to the assessment area framework, the OCC adopted suggestions of commenters by building additional incentives into the final rule, such as multipliers, designed to spur lending and investment activities in CRA deserts. *Id.* at 34758.

the CRA without the FRB, with the OCC moving forward alone with a final rule, which may ultimately blunt the effectiveness of any much-needed revisions.

The past decade has shown that even the business of banking is subject to the maxim that the only constant is change. Innovation in the financial sector will only expand as companies attempt to meet modern consumers' nearly insatiable appetite for increased speed and convenience. Institutions will need to divine ways to stay nimble to meet the demands of today's consumers, such as incorporating regulatory technology solutions into their existing systems and processes, or partnering with fintechs led by visionaries with a singular focus on individual issues, products, or services. The federal regulators are in a position to facilitate these efforts by tearing down the remnants of regulatory red tape that surfaced during markedly different eras for the banking industry, and as the above examples have shown, possess a number of tools to do so. In particular, regulatory recognition of the benefits of innovation and official encouragement to regulated entities to pursue innovative approaches evidences a willingness to support financial institutions outside the confines of the laborious notice-and-comment rulemaking process. How the regulatory agencies engage with regulated entities in the years ahead, as those companies continue to adapt to modern technological advancements and face competition from challengers outside the reach of existing law, will greatly shape the course of the financial services industry as a whole in this age of innovation.