

Treasury Calls for Banking Regulators to Harmonize and Modernize Permissible Activities of Banking Organizations

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The U.S. financial services industry continues to be faced with changes in technology – machine learning, database capabilities, automated process, and innovative products – that change the manner, speed and security with which financial services and products can be provided. Those of us familiar with the longer term evolution of financial services regulation over the last generation (including both those in the private sector and regulators) know that the regulatory framework within which banking organizations operate remains too fragmented. This framework needs updating to account for the technologies, not to mention consumer and business demands, of the 21st century. The [Treasury Department's report](#) on nonbank financial institutions, fintech and innovation recognizes this reality and recommends that banking regulators “should interpret banking organization's permitted scope of activities in a harmonized manner ... that recognizes the positive impact that changes in technology and data can have in the delivery of financial services.”

This recommendation would provide meaningful benefits to customers by providing flexibility to firms. This flexibility is not new. We have seen the U.S. banking regulators take this approach before when in the 1980s and 1990s the Federal Reserve often approved innovative proposals by BHCs and the OCC and FDIC (many forget the FDIC was previously more willing to consider innovative practices than in recent times) provided similar, and sometimes greater, flexibility for banks to engage in a wider range of innovative banking activities that were demanded by the market. The OCC's regulations continue to reflect this approach and encourage national banks to provide, perform, or deliver products and services through electronic and digital means that they have traditionally provided to customers.

Unfortunately the same cannot be said about all regulatory regimes, and the regulatory Balkanization that often exists presents unique challenges for investments in or partnership with fintech companies by banking organizations, as well as some illogical results, as some, including our former partner John Douglas, have astutely observed in two in-depth articles aptly entitled “[New Wine Into Old Bottles](#)” and “[Old Wine in New Bottles](#).”

For instance, both banks and BHCs may engage in data processing activities, but a BHC's ability to engage in data processing is limited to instances where no more than 49 percent of its revenues from that activity is derived from non-financial data; a national bank is not subject to those same limits. A BHC and national bank may also both provide management consulting services, but a BHC is subject to a 30 percent revenue limit on any consulting activities that do not relate to banking organizations or financial matters; again, a national bank is not subject to those same limits. Whatever sense these limits might have made in the era of punch cards and roomfuls of early IBM mainframes that were collectively less powerful than today's chips and processors found in our PCs and smart-phones, they make little sense now in an era of big data, real-time accessibility and machine learning. Moreover, it makes little sense for a BHC or non-bank affiliate of a bank to be more restricted in its ability to engage in activities than the bank itself.

We saw aspects of Treasury's recommendation adopted in practice last week through the announcement of the [Global Financial Innovation Network](#). This network will provide a “global sandbox” where regulators and financial services firms can innovate and share knowledge and experiences with the goal of creating a harmonized landscape for financial services. If the sandbox concept can be done on a cross-border basis by regulators from different countries, we are optimistic it can also be done on an inter-agency basis in the United States. A sensible harmonization of activities in which banking organizations are permitted to engage, coupled with the adoption of Treasury's companion recommendation for a reassessment of the Federal Reserve's BHC Act control framework would go a long way to encourage responsible innovation and help U.S. financial markets and institutions remain competitive. See our thoughts

on the recommendation for a reassessment of the Federal Reserve's BHC Act control framework [here](#).

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If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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