Government Accountability Office Annual Report Weighs Benefits and Risks of Consumer Fintech Products

April 28th, 2023 | Latif Zaman and Taylor A. Krowitz

Fintech is increasingly prevalent in the financial services marketplace, allowing providers to offer myriad innovative products and services that are dramatically changing how consumers can interact with financial service providers and access financial services. The Government Accountability Office's (GAO) annual report on financial service regulation, issued in March, addressed topics related to the growth of fintech. The preface to the report acknowledged fintech's potential to help consumers that are underserved by traditional financial institutions gain access to financial services, but also found it "unclear how many underserved consumers use [fintech] products, what risks they may pose, and to what extent existing financial services laws address those risks." The report, entitled "Financial Technology – Products Have Benefits and Risks to Underserved Consumers, and Regulatory Clarity is Needed," focused its review on four fintech products that, according to the GAO, "appeared to address barriers to financial access for consumers underserved by traditional banks": (1) digital deposit accounts, (2) credit builder products, (3) small-dollar fintech loans (defined as unsecured installment personal loans of $2,500 or less), and (4) earned wage access. The report examined the benefits, risks, and limitations of the selected fintech products for underserved consumers and what is known about the extent to which underserved consumers have used them, and the steps federal and state regulators are taking to assess the selected fintech products.

In gauging the benefits of the subject fintech products, the GAO compared the costs of the fintech products to the costs associated with what the GAO considered "comparable traditional or alternative financial products." The GAO also analyzed data obtained from fintech companies and empirical studies by federal agencies and researchers to determine the extent to which underserved consumers used the selected fintech products. The GAO's research on the risks related to the selected products, and the steps regulators are taking to assess the products, included reviewing regulators' examination procedures, regulatory guidance, examination reports, enforcement actions, and interviewing regulators.

The report concluded that fintech products may indeed offer benefits to underserved consumers, particularly those without bank accounts or credit scores. The report noted instances where fintech products offered lower costs to consumers than other comparable products and where the fintech products allowed for increased access to credit for consumers with limited credit files and no credit scores. The report noted data from polled fintech providers indicated that their products were mostly used by lower income consumers. However, the report also identified potential barriers for underserved consumers in accessing fintech products, such as the consumer lacking internet access or preferring "the individualized or inperson assistance of traditional banks" and ultimately determined that the "[d]ata on the extent to which fintech products serve underserved consumers [is] limited."

While much, but not all, of the price analysis in the report seemed to reflect relatively lower costs for consumers using the reviewed fintech products, the GAO concluded that there was also a risk to consumers that the costs, and other terms of fintech products may not be adequately transparent. For example, earned wage access providers sometimes give consumers the option to leave the company a "tip" after using the service. Ostensibly, the tip is voluntary (in most programs) and does not impact the decision to provide access to earned wages or the amount of the advance. The GAO noted concerns by consumer groups, however that consumers may be unaware that the tip is truly optional and may feel compelled to pay the additional cost, which would provide no additional benefit to the consumer. In connection with digital deposit accounts, the GAO noted the consumers may not be fully aware that the fintech company was not a bank and that their deposits were held by a separate institution. The report also noted that consumers may not be aware of the level of FDIC insurance coverage protecting a digital deposit account.

In addition to potential risks to consumers, the GAO identified certain risks for banks partnering with fintech companies. Arguably, such risks would largely be applicable to any third-party arrangement, and not specific to a fintech partnership, such as concerns regarding the fintech's compliance with laws governing the bank or liquidity concerns if a bank was overly reliant on the fintech relationship. However, the GAO also noted banks could face credit risks if the alternative credit underwriting models used by fintech partners lead to excessive losses for the bank. The GAO also raised concerns that alternative underwriting data, such as cash flow data, utility or rental payments, employment history, and level of education, "could have fair lending implications if the data correlate with groups of individuals protected under antidiscrimination laws and use of the data has a disproportionately negative impact on those groups." However, the report also pointed to research finding that cash flow information (the alternative data most commonly used by the fintech lenders interviewed for the report) was predictive of performance and did not correlate with race, ethnicity, or gender. Furthermore, the GAO acknowledged that using "alternative data in the underwriting process may extend access to credit to consumers with poor, thin, or no credit files by including data that credit reports do not typically capture." This, of course, would potentially increase the access to credit for underserved consumers.

In concluding the report, the GAO only made a single recommendation for execution action. The GAO called on the Consumer Financial Protection Bureau (CFPB) to provide further clarification on when an earned wage access product would be considered an extension of credit subject to the Truth in Lending Act ("TILA"). In 2020, the CFPB issued an advisory opinion taking the position that earned wage access products with certain characteristics would not be considered an extension of credit. Specifically, the opinion limits its application to an earned wage access product offered through an employer, with no fees charged to the employee whatsoever (voluntary or otherwise), and where the amount advanced would be recovered through an employer-facilitated payroll deduction, among other requirements. The advisory opinion did not explicitly address whether other earned wage access models would or would not be considered credit under TILA, leading to some confusion throughout the industry. The GAO report recommended that the CFPB clarify the application of TILA's definition of "credit" for earned wage access products not covered by its 2020 advisory opinion. The GAO report included in its appendix a letter from CFPB director Rohit Chopra concurring with its recommendation to provide further clarification on the application of TILA to earned wage access products. We note that, depending on the scope of the forthcoming guidance, it may have repercussions for other ostensibly non-credit products that also face recharacterization challenges.

While the report reiterated numerous common concerns about fintech products, it largely refrained from weighing potential harms against the potential benefits to consumers from the availability of fintech products. The report would have benefitted from further analysis on which of the concerns identified as creating a risk of harm were likely intrinsic to the fintech product, which of the concerns would likely be as prevalent in a non-fintech product, and which of the concerns were speculative pending further research. For instance, the report does not address whether the liquidity risk banks may face when overly reliant on a relationship with a fintech would also be prevalent in other non-fintech service provider relationships or strategic partnerships. Likewise, the potential fair lending risks from a fintech using alternative data in underwriting are hypothetical in that they largely reflect the lack of fair lending data available for any new underwriting method. The report did not provide substantial evidence supporting the position that alternative underwriting methods would have a negative impact on groups of individuals protected under antidiscrimination laws. On the other hand, concerns about consumers of digital deposit accounts being confused as to the party holding their account, and the available federal protections for their accounts, are arguably specific to the nature of the product. In such case, balancing of risks and benefits and the realistic measures to mitigate the risks, would be of heightened concern.

Another limitation of the GAO's report is that each selected product was analyzed in a vacuum, separate from other fintech products and services. Fintech companies often offer the products and services considered by the report in combination with each other. For example, a digital deposit account may be contemporaneously established for a consumer that has enrolled in a credit builder product and may also be offered in conjunction with a small dollar loan. Although the report outlines the benefits and risks of such products individually, the GAO does not contemplate whether additional benefits or risks arise when these products are offered in combination with one another.

A copy of the GAO report is available here: United States Government Accountability Office Report to Congressional Committees, "Financial Technology – Products Have Benefits and Risks to Underserved Consumers, and Regulatory Clarity is Needed." March 2023.