Wisconsin Legislative Council
INFORMATION MEMORANDUM

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FINANCIAL INSTITUTIONS AND SERVICES

To protect consumers, businesses, and the stability of the economy, state and federal law provide for extensive regulation of the financial industry. As a part of this regulatory system, a financial service provider must obtain a license or charter from the appropriate regulatory body before beginning operation and must abide by certain additional regulations that vary depending upon the field in which the provider works. This information memorandum provides an overview of the regulatory framework for various types of financial institutions and financial services.

DEPOSITORY INSTITUTIONS

Institutions that accept deposits ("depository institutions"), such as banks and credit unions, must undergo rigorous evaluation before receiving a charter, but may offer a wide range of services pursuant to that charter. Certain services, such as lending, may also be offered by nondepository institutions, upon receipt of a state-issued license that authorizes a limited range of activity but entails less regulation.

There are several types of depository institutions, each with its own legal form. However, the differences in business models that once distinguished one type from another have lessened over time. In the current era, the primary differences remaining are between banks and credit unions, and between depository institutions that are nationally chartered and those that are state-chartered. Because virtually all state-chartered depository institutions also are federally insured, both state- and federally-chartered depository institutions are subject to at least one federal primary regulator.[1]

Banks

Since the late 1800s, the United States has had a "dual banking system," in which both the federal government and the states have chartering and regulatory authority. Bank founders may choose to apply for a charter from either the federal government or a state, and may convert an existing charter.

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A bank's choice of charter determines: (1) which government agency will have primary responsibility for supervising the bank as its bank regulator; and (2) the extent to which it is subject to particular state and federal laws.

[1] See, e.g., Congressional Research Service, *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework*, March 10, 2020, at 11.

Chartering and Regulatory Agency

The Office of the Comptroller of the Currency (OCC), a bureau within the U.S. Department of the Treasury, charters and regulates national banks and savings institutions. National banks are required to become members of the Federal Reserve System (FRS) (which entails oversight by the Federal Reserve Board), and to obtain deposit insurance from the Federal Deposit Insurance Corporation (FDIC), which also conducts its own oversight activities.

The Wisconsin Department of Financial Institutions' (DFI) Division of Banking charters state banks and regularly examines them to ensure their sound and safe operation. [chs. 220 to 224, Stats.] Although Wisconsin law does not specifically require Wisconsin banks to obtain deposit insurance, all Wisconsin banks currently do so, and are subject to FDIC oversight. Additionally, Wisconsin banks may choose to join the FRS and submit to the associated oversight. [12 U.S.C. s. 321.] The extent to which a given bank has a preference for being supervised at the state or federal level depends on the fees charged by the supervisory agency, and the bank's perception of how well the agency's regulatory approach fits with the bank's business model.

Applicability of State and Federal Law

Whether a bank is chartered by the federal or state government determines the extent to which particular federal and state laws apply. Although significant differences remain, the regulatory treatment of national and state banks has generally converged as a consequence of efforts by state and federal regulators and lawmakers to protect the competitiveness of their respective banks.

Federal law determines the powers that national banks may exercise, and the U.S. Supreme Court has held that the states are preempted from enforcing any law that infringes on these powers.[2] As a result, large banks conducting multistate operations often choose a national charter in order to avoid being subject to varying state laws.

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To ensure the competitiveness of state banks in relation to national banks, many states have enacted laws generally referred to as "wild card statutes" that grant their state-chartered banks the power to engage in any activity in which a nationally chartered bank may engage. For example, Wisconsin law authorizes the Division of Banking to, by rule, authorize state banks to "exercise any right, power or privilege permitted national banks under federal law, regulation or interpretation." [s. 220.04 (8), Stats.] However, the statute does not authorize the Division of Banking to use this authority to make changes relating to the protections afforded to consumers under the Wisconsin Consumer Act (WCA), discussed in a later section.

States have also tended to provide their own state-chartered banks with powers that national banks do not have, especially with regard to insurance underwriting, real estate, and corporate underwriting. [Michael S. Barr, Howell E. Jackson, and Margaret E. Tahyar, *Financial Regulation: Law and Policy* (2016), pp. 176-177.] For example, Wisconsin law provides Wisconsin-chartered banks the option of becoming a "Universal Bank," thereby acquiring additional authority to exercise all powers necessary or convenient to effect the purposes for which the bank is organized or to further the business in which the bank is engaged. [ch. 222, Stats.]

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[2] *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996).

The extent to which states may do this, however, has been limited by the FDIC Improvement Act of 1991, which generally requires state-chartered banks seeking deposit insurance to obtain approval from the FDIC before engaging in any activity that nationally chartered banks are not authorized to engage in. [12 U.S.C. s. 1831a.]

Many states, including Wisconsin, have also sought to protect the competitiveness of their banks in relation to banks chartered by other states ("out-of-state banks"). To this end, many states have enacted various "reciprocity statutes" that condition the exercise of powers by out-of-state banks on reciprocal approvals for its banks by other states. For example, Wisconsin law prohibits an out-of-state bank from establishing a branch in Wisconsin unless the Division of Banking determines that the laws of the home state of the out-of-state bank are reciprocal with respect to a Wisconsin bank establishing a branch in that state. [s. 221.0904 (2) (b), Stats.]

Credit Unions

Credit unions may be nationally chartered and regulated by the National Credit Union Administration (NCUA), or state-chartered and regulated by the Wisconsin Office of Credit Unions, which is attached to DFI for administrative purposes only. [12 U.S.C. s. 1754; ch. 186, Stats.]

Credit unions are owned cooperatively by individuals or organizations sharing a "common bond," and are operated on a not-for-profit basis for the benefit of their members, who each receive one vote, regardless of the size of their deposit. For these reasons, and "because they have the specified mission of meeting the credit and savings needs of consumers, especially persons of modest means," credit unions are exempt from most taxes. [Credit Union Membership Access Act, P.L. 105-219.]

Federal law exempts nationally chartered credit unions from federal, state, and local income tax; state and local sales tax; and from any taxes on franchises, reserves, or capital. However, federal law does not provide an exemption from taxes on real or personal property. [12 U.S.C. s. 1768.]

Federal law also exempts state-chartered credit unions from federal income tax, but gives each state discretion to decide whether to impose other taxes. In Wisconsin, Wisconsin-chartered credit unions are exempt from state income tax. [26 U.S.C. s. 501 (14) (a); s. 71.26 (1) (a), Stats.]

Accounts in nationally and state-chartered credit unions are insured through the National Credit Union Share Insurance Fund administered by NCUA. [ch. 186, Stats.]

Both nationally and state-chartered credit unions are generally prohibited from providing services to any person or organization who does not meet the credit union's membership criteria. Generally, a credit union's membership must be limited to one of the following categories: (1) a single group that has a common bond of occupation or association; (2) more than one group, each of which has a common bond of occupation or association meeting certain criteria; or (3) persons or organizations within a well-defined community. [s. 186.02 (2) (b), Stats.; 12 U.S.C. s. 1759 (b).]

A credit union's membership must be limited to members of certain groups with a "common bond" or to persons or organizations within a well-defined community.

Savings Institutions

Savings institutions, also referred to as "thrifts," comprise the third general category of depository institutions. These institutions may take the form of a savings and loan association or

a savings bank, can be chartered at the national or state level, and may convert an existing charter. Savings institutions generally focus on real estate financing, and must maintain a certain portion of their portfolio in housing-related assets. [chs. 214 and 215, Stats.]

NONDEPOSITORY INSTITUTIONS

A business or individual that is not authorized as a depository institution may nonetheless provide financial services, such as lending or facilitating payments, by obtaining the appropriate license from DFI, which licenses and oversees the practices of:

- **Loan companies** engaged in the business of making loans. [s. 138.09, Stats.]
- **Payday lenders** engaged in the business of making short-term loans that are secured by checks or electronic funds transfer authorizations signed by the borrower. [s. 138.14, Stats.]
- **Mortgage bankers, brokers, and loan originators** engaged in the business of mortgage lending. [ss. 224.71, 224.72, and 224.725, Stats.]
- **Sales finance companies** engaged in the business of purchasing retail installment contracts and consumer leases from motor vehicle retail sellers and lessors. [s. 218.0101, Stats.]
- **Community currency exchanges** engaged in the business of cashing checks and handling money orders. [s. 218.05, Stats.]
- **Sellers of checks** engaged in the business of transmitting money. [ch. 217, Stats.]
- **Insurance premium finance companies** engaged in the business of advancing funds to enable another party to pay the premiums necessary to acquire insurance. [s. 138.12, Stats.]

REGULATION OF CONSUMER FINANCE

As noted previously, the WCA provides certain protections to consumers. Specifically, the WCA is intended to:

- Protect customers against unfair, deceptive, false, misleading, and unconscionable practices by merchants.
- Permit and encourage the development of fair and economically sound consumer practices in consumer transactions.
- Coordinate the regulation of consumer credit transactions with the federal Consumer Protection Act. [s. 421.102 (2), Stats.]

The WCA applies to any "consumer credit transaction," which generally includes any transaction of up to $25,000 involving a finance charge or payment of more than four installments, and which is with an individual who is engaging in the transaction for personal, family, or household purposes. The most common examples of consumer credit transactions are loans, credit cards, credit sales, and leases. [s. 421.301 (10) and (17), Stats.]

The WCA applies to personal, family, or household transactions of up to $25,000 that involve a finance charge or payment of more than four installments.

Among other provisions, the WCA: (1) prohibits agreements from including certain contract terms that are considered to be disadvantageous to consumers; (2) requires certain disclosures to be made to a consumer; (3) provides consumers a right to prepay and prescribes mandatory

rebates for prepayment; (4) mandates that certain notices be provided to consumers and limits the circumstances under which certain charges may be levied upon a consumer; (5) provides a consumer with certain rights and opportunities to cure a default before it results in adverse consequences; and (6) regulates debt collection practices. [chs. 421 to 427, Stats.]

DFI is responsible for administering the WCA and may investigate complaints, conduct hearings, and commence civil actions through the Department of Justice. [s. 426.104, Stats.] Additionally, DFI is authorized to define, by rule, the conduct in consumer transactions and debt that is unconscionable and to prohibit that conduct. [s. 426.108, Stats.]

At the federal level, the Consumer Financial Protection Bureau (CFPB) has broad regulatory authority over businesses, including banks, credit unions, and the mortgage industry, as well as payday lenders, debt collectors, the student loan industry, and other consumer finance transactions. The CFPB was created in 2011 pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act.

INTEREST RATE REGULATION

Wisconsin law generally imposes no limitations on the interest rate that may be charged. Prior Wisconsin laws capping the interest rate ("usury laws") were repealed over the course of the 1980s and 1990s, in part because of federal actions depriving states of the authority to apply their usury laws to all creditors.

In 1978, the U.S. Supreme Court held that a nationally chartered bank, credit union, or savings association could "export" the maximum interest rate allowed under the laws of its home state. As a result, Wisconsin's usury laws became unenforceable against nationally chartered banks, credit unions, and savings associations with a home state other than Wisconsin, and these financial institutions became authorized to charge Wisconsin residents any interest rate authorized under the laws of their home state. [*Marquette National Bank v. First of Omaha*, 439 U.S. 299 (1978); 12 U.S.C. ss. 85 and 86.]

Federal law was subsequently amended to additionally apply the same rule to any federal-insured, state-chartered bank, credit union, or savings association, although the law provides options for a state to limit the applicability within its borders. [12 U.S.C. ss. 1463 (g), 1757 (5), 1785 (g), 1813 (a), and 1831d.]

Wisconsin largely deregulated interest rates during the 1980s, and repealed its remaining usury limits in 1996, following the actions of certain states, such as South Dakota, to eliminate their usury limits. The stated purpose of this legislation was to enable Wisconsin-based creditors to compete with out-of-state creditors, who take advantage of federal law to charge interest rates and fees allowed by their home states to Wisconsin residents. [chs. 45 and 100, Laws of 1981; 1989 Wisconsin Act 31; 1995 Wisconsin Act 328; Aaron Gary, *Regulating Credit Card Interest Rates and Fees*, Wisconsin State Bar Business Law News, June 17, 2009.]

DEBT MANAGEMENT, COLLECTION, AND RESTRUCTURING

DFI licenses and regulates the conduct of organizations in the areas of credit management and debt obligations. Both credit service organizations, which are engaged in the business of assisting a buyer in obtaining credit or improving its credit rating, and adjustment service companies, which are engaged in the business of assuming the obligations of a debtor by purchasing the accounts a debtor has with a creditor, must obtain a license and abide by certain consumer protection provisions of the WCA. [ss. 218.02, 422.501, and 422.502, Stats.]

Wisconsin law requires a debt collection agency to be licensed, and prohibits a debt collection agency from using any "oppressive or deceptive" practice, including:

- Using or threatening to use force or violence.
- Threatening criminal prosecution.
- Communicating with a debtor with such frequency, at such hours, or in such a manner that can reasonably be expected to harass the debtor.
- Using obscene, profane, or threatening language.
- Contacting a debtor by telephone following a request by the debtor that such collection efforts cease.
- Claiming or attempting to threaten or enforce a right with knowledge that the right does not exist.
- Communicating or threatening to communicate with the debtor's employer before obtaining a final judgment against the debtor.
- Disclosing or threatening to disclose false information adversely affecting the debtor's reputation, or any information affecting the debtor's reputation with reason to know that the person to whom it is disclosed does not have a legitimate business need for the information.

Wisconsin law requires a debt collection agency to be licensed, and prohibits a debt collection agency from using any "oppressive or deceptive" practice.

[ss. 218.04 and 427.104, Stats.; s. DFI-Bkg 74.16, Wis. Adm. Code.]

While Wisconsin law regulates debt collection, bankruptcy is governed entirely by the federal Bankruptcy Code. [11 U.S.C. ss. 101-1532.] The U.S. Constitution grants Congress the authority "to establish…uniform Laws on the subject of Bankruptcies throughout the United States." [U.S. Const. art. I, s. 8, cl. 4.] Wisconsin law provides an alternative system of debt restructuring commonly referred to as a "Chapter 128 Action," in which a debtor may be able to stop further debt from accruing and to develop a plan for resolving debts. [s. 128.21, Stats.]

REGULATION OF SECURITIES TRANSACTIONS

A broad scope of investment arrangements qualify as securities under Wisconsin and federal law. The definition of "security" generally encompasses any arrangement that involves an investment in a common enterprise with the expectation that the investor may receive profits resulting from the managerial efforts of someone else. [s. 551.102 (28), Stats.]

Generally, securities laws are intended to protect investors by: (1) requiring issuers of securities to register the securities with the appropriate regulatory body and disclose information about the nature and risks of the securities; (2) requiring securities professionals and businesses to be licensed; and (3) prohibiting fraudulent and misleading conduct.

Registration of Securities and Disclosure by Issuers

The primary purpose for mandating the registration of securities is to protect the investing public from being disadvantaged by a lack of access to material information about an investment. Protecting investors in this way, however, imposes costs that may impede issuers, particularly small businesses, from obtaining the capital needed to start or expand operations. To address this concern, federal and state law provide exemptions from registration requirements.

A security may be required to be registered with the federal government, the state government of each state in which it is offered, or both. Certain securities, referred to as "federal covered securities," such as those approved to be listed on a national exchange, must be registered with the federal Securities and Exchange Commission (SEC), but need not be registered at the state level. [15 U.S.C. s. 77r (a) (1) (A) and (b) (1) (A).] Conversely, securities that are offered and sold only to residents within a single state by an issuer that is incorporated under the laws of and is doing business in that state, need not be registered with the SEC. [15 U.S.C. ss. 77c (a) (11) and 77e (a).]

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Uniform Securities Act

To facilitate compliance by issuers, most states, including Wisconsin, have collaborated to make their registration requirements uniform by enacting statutes that largely fit with a "Uniform Securities Act" developed by the National Conference of Commissioners on Uniform State Laws. [2007 Wisconsin Act 196.] Among other items, the uniform provisions exempt certain securities, such as those issued by a highly regulated entity (e.g, a public utility) from registering at the state level. [s. 551.201 (1), (3), (5), and (7), Stats.] The Legislature may modify, supplement, or refuse to enact any provision recommended by the Uniform Securities Act.

Registration of Securities in Wisconsin

For securities that must be registered in Wisconsin, the issuer must submit to DFI extensive information regarding the issuer's financial status, employees, and owners, as well as a description of how the proceeds of the offering will be used. [ss. 551.304 (2) and 551.305, Stats.; s. DFI-Sec 3.02 (1), Wis. Adm. Code.] DFI reviews the information to determine if it is complete and true in all material respects. [ss. 551.304 (3) and (4), 551.305 (8), and 551.306 (1), Stats.]

Licensing of Securities Professionals and Businesses

To protect investors, Wisconsin and federal law provide that certain securities transactions may only be conducted by service providers that are registered with the SEC and DFI.

Requirements for Brokers and Broker-Dealers

Generally, a "broker" is any person engaged in the business of buying or selling securities for another person, and a "dealer" is any person engaged in the business of buying or selling securities for the person's own account, such as a firm's own investment account. A "broker-dealer" is a person engaged in the business of acting as a broker, a dealer, or both. [s. 551.102 (4), Stats.]

Most broker-dealers must be registered with both the SEC and DFI. [s. 551.401 (1), Stats.] Both federal and Wisconsin law require a broker-dealer to pass certain examinations of professional competence, and adhere to certain standards of conduct. [s. DFI-Sec 4.01 (3), Wis. Adm. Code.] In most instances, a company registers as a broker-dealer or an investment adviser, and the individuals working for the company register as securities agents and investment adviser representatives, respectively.

Wisconsin law requires that each broker-dealer must: (1) maintain minimum amounts of net capital; (2) limit aggregate indebtedness to within a specified range; (3) maintain certain records; (4) comply with reporting requirements that include filing with DFI an annual financial

statement and a copy of every complaint against it; and (5) comply with certain rules of professional conduct in serving clients. [ss. DFI-Sec 4.02, 4.03, and 4.04, Wis. Adm. Code.]

Requirements for Investment Advisers

"Investment advisers" are persons who are in the business of advising others on the value of securities or the advisability of buying or selling securities. [s. 551.102 (2), (4), (15), and (16), Stats.] Generally, an investment adviser must be registered with the SEC if managing $110 million or more, and may be registered with the SEC if managing $100 million or more. Federal law prohibits Wisconsin from requiring investment advisers registered with the SEC to be registered with DFI. Investment advisers who are not registered with the SEC must be registered with DFI if they maintain a place of business in Wisconsin, or have six or more Wisconsin residents as clients during a 12-month period. [s. 551.403, Stats.; 15 U.S.C. s. 80b-3a.]

To be licensed in Wisconsin, an investment advisor must pass certain examinations or have obtained certain professional certifications intended to verify professional competence. [s. DFI-Sec 5.01 (3), Wis. Adm. Code.] Each investment adviser must maintain positive net worth in certain specified amounts; maintain certain records; comply with reporting requirements that include annually filing with DFI a copy of every complaint against it; and comply with certain standards of professional conduct in serving clients. [ss. DFI-Sec 5.02, 5.03, 5.04, and 5.06, Wis. Adm. Code.]

Fraudulent and Misleading Conduct

Wisconsin law prohibits a person, in connection with the offer, sale, or purchase of a security, from: (1) employing a scheme to defraud; (2) making an untrue statement of material fact; (3) omitting to state a material fact necessary in order to prevent a statement from leading another person being misled; or (4) engaging in an act, practice, or course of business that operates as a fraud upon another person. [s. 551.501, Stats.]

THE FINANCIAL TECHNOLOGY ("FINTECH") INDUSTRY

Since the mid-2010s, a variety of financial services have been offered by financial technology ("fintech") companies that deploy the Internet, mobile communication devices, proprietary algorithms, and other information technology as a means of providing service. These companies include:

- **Marketplace lenders**, such as Lending Club and Prosper, which use algorithms to identify credit-worthy individuals and businesses and use an online platform to connect them with interested lenders.
- **Mobile payment systems and mobile wallets**, such as Square and Venmo, which enable users to make purchases and transfer money via an online account and a smartphone, thereby avoiding the need to use cash, credit card, or a check.
- **Digital wealth management platforms**, which use algorithms based on information provided by an investor in order to provide that investor with financial management and investment advice.
- Providers of **virtual currencies**, such as Bitcoin, which use distributed ledger ("blockchain") technology to facilitate the transfer of digital assets.

The new manner in which the services are provided, as well as the multistate nature of the companies' operations, have raised questions regarding how they should be regulated. Fintech

companies are regulated at the national level by both banking regulators and consumer protection agencies. Banking regulators may respond to issues raised by fintech companies in several ways, such as by issuing guidance to clarify how rules apply to new products, supervising the relationships formed by financial institutions and fintech companies, and granting banking licenses to fintech companies.[3]

In 2016, the U.S. Office of the Comptroller of the Currency (OCC) announced plans to explore the possibility of granting a national charter to certain types of fintech companies. OCC argues that it may issue bank charters to fintech companies under the authority of the National Banking Act, which authorizes OCC to charter national banks "to commence the business of banking," and describes national banks as "associations to carry on the business of banking." [12 U.S.C. ss. 21 and 27 (a).] Proponents of the idea argued that it would facilitate fintech operations by exempting them from state licensing laws, which vary from state to state. However, multiple lawsuits have challenged OCC's authority to grant bank charters to fintech companies, and litigation is ongoing.[4]

In Wisconsin, DFI has been engaged in analyzing the extent to which Wisconsin law authorizes it to regulate various fintech activities. DFI has concluded that Wisconsin's seller of checks laws do not authorize it to regulate or license virtual currency transmitters. DFI has, however, joined an initiative coordinated by the North American Securities Administrators Association to take action in response to virtual currency offerings that violate securities fraud laws.

This information memorandum was prepared by Tom Koss, Staff Attorney, on December 4, 2020.

[3] See Congressional Research Service, *Fintech: Overview of Financial Regulators and Recent Policy Approaches*, April 28, 2020, at 7.

[4] See, e.g., Congressional Research Service, *Court Battle for Fintech Bank Charters to Continue*, December 6, 2019.