

OCC EXPLORES SPECIAL PURPOSE NATIONAL BANK CHARTER FOR FINTECH COMPANIES

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FinTech Alert

By: Judith Rinearson, Anthony R.G. Nolan, Rebecca H. Laird, Jeremy M. McLaughlin

On December 2, 2016, the Office of the Comptroller of the Currency ("OCC") announced its plans to move forward with a proposal to consider applications from financial technology ("fintech") companies to receive charters as special purpose national banks. The OCC simultaneously released a white paper detailing the program. The OCC is seeking comments on its proposal, including responses to 13 specific questions listed in the paper. The comment period ends on January 15, 2017.

The announcement is potentially significant for the fintech sector because it could relieve them of needing to register or obtain licenses in various states and face differing sets of laws and restrictions. It may also move the US regulatory climate for this industry closer to that of the UK, where (i) the Financial Conduct Authority ("FCA") has taken the position that marketplace lenders should be regulated as banks; and (ii) e-money issuers require only one central license (rather than multiple licenses for each province or county), which (subject to Brexit) can also be "passport" to other EU jurisdictions.

There are, however, questions about how broadly or fundamentally a fintech banking charter would change the market, particularly considering that capital adequacy requirements and compliance requirements would make this development of greatest usefulness only for the larger fintech platforms. There is also an open question whether a bank charter would constrain the innovation that has differentiated the fintech industry from the traditional banking industry. In addition, a national bank charter will not help the fintech industry to obtain more stable funding unless fintech banks are permitted to take deposits, which would require determinations and regulatory oversight by the Federal Deposit Insurance Corporation (the "FDIC").

This announcement is the latest salvo from the OCC as it tries to get ahead of the curve with innovation efforts. Earlier this year, the agency announced its plan to establish an Office of Innovation. By establishing that office and now proposing a national fintech charter, it appears the agency seeks to remain a central player in overseeing emerging financial services companies, even as other agencies—federal and state—are deciding their own approaches to this developing trend.

OVERVIEW OF THE OCC'S PROPOSED SUPERVISORY FRAMEWORK FOR FINTECH COMPANIES

Although the relationship between the fintech industry and traditional banking is a key emerging theme in this space, the proposal reflects the growth of fintech companies as alternative sources of credit and financial services to consumers and small businesses. In his announcement of this move, Comptroller of the Currency Timothy Curry stated that "[i]t will be much better for the health of the federal banking system and everyone who relies on

those institutions, if these companies enter the system through a clearly marked front gate, rather than through some back door."

The OCC's white paper expresses three reasons why the agency believes it is in the public interest to provide the special interest charter. These are to ensure that fintech companies operate "in a safe and sound manner"; to promote "consistency" in governing law and regulation; and to "make the federal banking system stronger." On the last point, the OCC believes its oversight would encourage fintech companies to "explore new ways to promote fair access and financial inclusion and innovate responsibly."^[1] Given that fintech companies have been successful largely because of their innovation in bringing financial services to new communities, it remains to be seen whether having an OCC charter causes any change in promoting fair access and financial inclusion.

The OCC's white paper lays out the supervisory standards that would be required of fintech companies, although it acknowledges that requirements could be tailored to the size, complexity, and risks of the company and its activities. Some of these requirements are having a well-developed business plan, a corporate governance structure, and a recovery and exit strategy. A company would also need to meet capital and liquidity requirements. The white paper notes that for a fintech company with off-balance sheet business activities, the agency may require the company to hold a specific amount of capital that would often exceed the capital requirements for other types of banks.^[2] A fintech company would also need to have in place a compliance management program, although the OCC recognizes that applying a typical compliance management program "to a fintech company's business model could raise novel considerations" and so it will "consider and address in its evaluation of a fintech charter application whether and how innovative elements of a business model may affect the proposed bank's compliance risk profile."^[3] Finally, the agency would require the company to have a program aimed at financial inclusion to insure the special purpose bank treats customers fairly and provides access to financial services that respond to the needs of the community, especially if the company engages in lending. It will be interesting to see how the agency evaluates this standard given that many fintech companies are aimed precisely at providing financial services to communities not served by traditional financial institutions.

The white paper provides details on a proposed four-stage chartering process. It concludes by seeking comment on the paper as a whole, as well as responses to 13 specific questions (with several of them focused on financial inclusion).

WILL THE SPECIAL FINTECH BANK CHARTER PROMOTE UNIFORMITY OF REGULATION?

A key benefit of the special purpose charter for fintech companies would be the uniformity it brings. The white paper notes that the special purpose charter would be subject to the same laws that cover a national bank. This includes National Bank Act preemption: "State law applies to a special purpose national bank in the same way and to the same extent as it applies to a full-service national bank."^[4] The paper explicitly notes that state licensing requirements would not apply. However, as with national banks, some state laws would apply, such as laws "that only incidentally affect" a national bank's authorized powers.^[5]

Whether other laws would apply to a fintech company would depend on the company's activities. For example, various federal statutes would apply if the fintech company originated residential real estate loans. The OCC noted that other laws applying to special purpose banks include the Bank Secrecy Act, other anti-money

laundering laws, and the economic sanctions administered by the Treasury Department's Office of Foreign Assets Control. Interestingly, despite the OCC's suggestion that the Bank Holding Company Act ("BHCA") and Federal Reserve Board ("FRB") regulation could apply to the holding company parent of a fintech national bank, the BHCA applies only to FDIC insured institutions or entities that both take demand deposits and make loans. Thus the parent of a fintech company that is not FDIC insured and doesn't both take deposits and make loans would not be subject to the BHCA or FRB regulation under the BHCA.[6] In addition, the full breadth of the CFPB authority, as applied to national banks generally, would not apply to fintech national banks.[7]

But fintech companies aren't completely in the clear when it comes to escaping regulation by some statutes that wouldn't otherwise apply. Even where a law would not apply directly to a company, the OCC says it may work with a fintech company to nonetheless "achieve the goals of a particular statute or regulation through the OCC's authority to impose conditions on its approval of a charter." [8] The agency would do so "if it deems the conditions appropriate based on the risks and business model of the institution." [9] So, although some fintech companies may want this charter for uniformity sake, companies should be aware that the OCC may be requiring them to submit to requirements that may not otherwise reach them. This would be implemented in practice by the fintech company receiving the same charter as a national bank, but the special purpose would be effectuated through limiting its activities through the bank's article of association or through OCC-imposed conditions for approving the charter.[10] Moreover, an applicant "may be required, as a condition of approval, to enter into an 'operating agreement' with the OCC containing the substantive charter conditions." [11]

THE OCC'S CLAIMED BASIS OF AUTHORITY FOR GRANTING SPECIAL FINTECH BANK CHARTERS

The OCC's authority to grant a special charter as contemplated by the white paper, and the scope of fintech companies that would be eligible to become a bank, are open issues. The white paper states that such a charter is permitted "so long as the entity engages in fiduciary activities or in activities that include receiving deposits, paying checks, or lending money." [12] Previously, many in the industry had thought any fintech banking charter would be focused solely on companies that lend money, but by including "paying checks," the OCC is clearly taking an expansive view of the new charter, including prepaid payments, remittances, debit cards, P2P programs, and other innovative financial service companies.

The white paper explains that the OCC views the National Bank Act as "sufficiently adaptable to permit national banks—full-service or special purpose—to engage in new activities as part of the business of banking or to engage in traditional activities in new ways." [13] Because of the novel business approach of some fintech companies, however, the OCC acknowledges that it "may need to account for differences in business models and the applicability of certain laws." [14]

Unlike the special bank charter for trust banks (which requires FDIC insurance), whether provisions of the Federal Deposit Insurance Act would apply to a fintech company would depend on whether the company accepted deposits. In September 2016, the agency had indicated it expected most fintech companies could apply as nondepository institutions, which would mean they could avoid certain requirements that come with being supervised and insured by the FDIC. On the other hand, fintechs that receive "deposits"—and funds underlying prepaid card accounts have been defined as "deposits"—may still require FDIC insurance.

INITIAL REACTIONS

In the few days since the OCC's announcement, there have been mixed reactions. Some larger banks praised the effort because they see it as somewhat leveling the playing field by subjecting fintech companies to some of the stringent requirements the banks face. However, community and independent banks reacted warily to the announcement. They take issue with the OCC's apparent willingness to alter some of the typical charter requirements—such as capital and liquidity requirements—based on the business model of a fintech company. They argue that if a fintech company receives a bank charter, it should be held to all the same high standards that currently apply to banks. Some fintech companies have expressed concern about whether this will accentuate consolidation in the fintech sector and whether it will stifle the innovation that has been a defining characteristic of the industry.

It's also expected that the Conference of State Bank Supervisors will oppose the action. Last month, the organization submitted a comment letter strongly criticizing any move by the OCC to establish a federal fintech charter. The comments focused largely on four critiques: (1) OCC actions would distort the market place because it would centralize authority in one regulator, and the rules of that regulator would inevitably benefit some to the exclusion of others; (2) OCC's history of preempting state consumer protection laws indicates it would likely do the same for fintech companies and thus risk consumer and market harm; (3) the OCC lacks authority to establish a charter unless an entity is engaged in "the business of banking, including deposit taking"; (4) state regulators are in a better position to balance regulation of these entities without stifling innovation. Although the white paper discusses certain coordination that will occur among federal regulators overseeing companies that receive this special purpose charter, there is little discussion as to the role of state regulators.

NEXT STEPS

As banks, fintechs, and financial service companies assess their response to the OCC's fintech charter proposal, K&L Gates is in a unique position to help. Our global Fintech Group, Marketplace Lending group, and Emerging Payments group will all be analyzing the impacts and monitoring developments closely.

In addition, our Public Policy Group in Washington, DC will be able to assist the fintech industry in assessing the potential legislative impact of the new administration on the OCC's proposed fintech charter. The impact could be significant, especially if Chairman Hensarling's Financial Choice Act (FCA) is passed in its current form. Under the FCA, both the OCC and the CFPB would be converted into a 5 member commission, subject to new cost benefit analysis requirements.[15]

NOTES:

[1] Office of the Comptroller of the Currency, Exploring Special Purpose National Bank Charters for Fintech Companies (Dec. 2016) ["white paper"], at 2.

[2] See *id.* at 10.

[3] *Id.* at 11.

[4] *Id.* at 5.

[5] *Id.*

[6] Consequently, it should be easier for fintech companies to raise money from large company investors that do not want to be subject to the BHCA.

[7] *Id.* at 8 n.24 (*citing* 12 U.S.C. § 5514 which defines that scope of coverage for CFPB's authority over nondepository covered persons).

[8] White paper, at 2.

[9] *Id.* at 6.

[10] *Id.* at 5 n.11.

[11] *Id.* at 14 n.35.

[12] *Id.* at 3-4.

[13] *Id.* at 4.

[14] *Id.* at 2.

[15] See K&L Gates Public Policy Alert: *The Financial CHOICE Act; Dodd-Frank Reform (Not Repeal)*.

KEY CONTACTS



JUDITH RINEARSON
PARTNER
NEW YORK, LONDON
+1.212.536.3928
JUDITH.RINEARSON@KLGATES.COM



ANTHONY R. NOLAN
PARTNER
NEW YORK
+1.212.536.4843
ANTHONY.NOLAN@KLGATES.COM



REBECCA H. LAIRD
OF COUNSEL
WASHINGTON DC
+1.202.778.9038
REBECCA.LAIRD@KLGATES.COM



JEREMY M. MCLAUGHLIN
PARTNER
SAN FRANCISCO
+1.415.882.8230
JEREMY.MCLAUGHLIN@KLGATES.COM

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