May 3, 2019

Federal Court Issues Decision Denying OCC's Ability to Issue National Bank Charters to Non-Depository "FinTechs"

Southern District of New York Rules in Favor of the N.Y. Department of Financial Services's Claims That Chartering Decision Exceeded Scope of Comptroller of the Currency's Authority Under the National Bank Act

SUMMARY

Since 2016, the Office of the Comptroller of the Currency ("OCC") has been investigating the possibility of issuing special purpose national bank ("SPNB") charters to non-depository financial technology ("fintech") companies that lend money. OCC's stated purpose in doing so is to extend the availability of credit, help modernize and strengthen the banking system, and afford chartered lenders federal preemption of the non-uniform state licensing requirements and regulation to which they would otherwise be subject. In July 2018, OCC announced that it would begin accepting applications for SPNB charters for such entities, and several entities have reportedly begun the application process.

The N.Y. Department of Financial Services ("DFS") sued OCC, claiming that issuing SPNB charters to non-depository institutions exceeded OCC's authority under the National Bank Act ("NBA"), and thus improperly usurped DFS's regulatory authority over such institutions. On May 2, 2019, Judge Victor Marrero of the U.S. District Court for the Southern District of New York issued a decision denying OCC's motion to dismiss DFS's complaint, and determining that OCC lacks authority under the NBA's "business of banking" provision to offer charters to non-depository fintechs.[1]

Although Judge Marrero's ruling is not a decision on the merits of DFS's claims, its reasoning seemingly leaves no doubt that he will ultimately enjoin OCC from issuing SPNB charters to non-depository

institutions. Accordingly, if OCC intends to continue to pursue the issuance of such charters, it will need to seek redress from the appellate courts or seek a Congressional amendment to the NBA.

BACKGROUND FACTS

In December 2016, OCC published a white paper entitled *Exploring Special Purpose National Bank Charters for Fintech Companies*, in which it noted that it was considering granting SPNB charters to non-depository fintechs based on its authority under the NBA.[2] In March 2017, OCC responded to comments it received on the white paper and issued a draft supplement to its licensing manual concerning how it would evaluate applications from fintechs for SPNB charters.[3] The motivation for the OCC's action was to ensure that fintech businesses could safely and efficiently serve the needs of customers, including consumers and small businesses, across state jurisdictions without facing various disparate sets of licensing requirements and other regulations. In the past, one way in which non-depository fintech lenders have addressed this concern was to partner with national or state-chartered banks in issuing loans, affording them preemption of state laws under the NBA and the Federal Deposit Insurance Act ("FDIA"). That model, however, has had its *bona fides* threatened by multiple litigation trends working their ways through the courts. In one example, state regulators and private plaintiffs have alleged that the non-bank lending partner in the partnership model is the "true lender," and thus the preemption protections of the NBA and FDIA against state laws do not apply to the fintech lender. The Second Circuit Court of Appeals's 2015 *Madden* v. *Midland Funding, LLC* decision,[4] which held, in conflict with the long-standing valid-when-made principle, that a loan originated by a national bank loses its entitlement to federal preemption when it is sold to a non-depository institution, constitutes an additional risk for fintech lenders, both within the Second Circuit and, given the possibility of its adoption elsewhere, outside of that jurisdiction. A benefit of accessing the SPNB charter would thus be to allow the fintechs to make the loans directly and still avoid the burdensome regulation of multiple state jurisdictions.

In May 2017, DFS sued OCC in the Southern District of New York, asserting that the decision to issue SPNB charters to non-depository fintechs exceeded OCC's authority under the NBA and violated the Tenth Amendment. Judge Naomi Reice Buchwald dismissed that case on standing and ripeness grounds in December 2017, holding that the case had been filed prematurely because OCC "had not yet determined whether it will issue SPNB charters to fintech companies" and that, in the absence of such a decision, "DFS's purported injuries are too future-oriented and speculative" to support standing or render the case ripe for decision.[5]

On July 31, 2018, OCC announced that it would accept applications for SPNB charters from fintech businesses, including those not engaged in taking deposits ("Decision").[6] OCC has reportedly been in conversation with potential applicants regarding the SPNB charter application process. On September 14, 2018, DFS sued OCC again, claiming that the Decision and the supporting OCC regulation exceeded OCC's statutory authorization under the NBA and violated the Tenth Amendment.

DFS sought declaratory and injunctive relief against the Decision. OCC moved to dismiss in February 2019, arguing that DFS lacked standing, the dispute was unripe and time-barred, and, in any event, DFS failed to state a claim because OCC's interpretation of the NBA to allow it to issue SPNB charters to non-depository institutions was entitled to deference under the Supreme Court's *Chevron* doctrine, which allows agencies to apply reasonable interpretations to ambiguous statutory language.

THE DECISION

In denying OCC's motion to dismiss in principal part, Judge Marrero agreed with DFS's interpretation of the NBA as prohibiting OCC from issuing national bank charters to fintech businesses not engaged in the taking of deposits. In his words, the NBA "unambiguously requires that, absent a statutory provision to the contrary, only *depository* institutions are eligible to receive national bank charters from OCC."[7]

First, however, Judge Marrero grappled with OCC's renewed threshold challenges to DFS's lawsuit on the basis of standing, ripeness, and the statute of limitations. OCC argued, as it had in the first DFS lawsuit, that DFS could not show that it had been injured by the Decision or that its lawsuit was ripe for adjudication because OCC had not yet issued any SPNB charters to non-depository fintech applicants. Judge Marrero rejected these arguments on the basis that standing exists where an injury is "certainly impending" and that state-actor plaintiffs' assertions of standing are owed "special solicitude," particularly where they are acting to protect "sovereign" interests.[8] He relied on (i) DFS's asserted interest in establishing financial protections for the citizens of New York and (ii) its deprivation of revenues from assessments levied on its regulated entities[9]—here, fintechs whose SPNB charter would permit them to avoid state regulation—concluding that the injury was sufficiently imminent because "OCC has the clear expectation of issuing SPNB charters."[10] Judge Marrero also rejected OCC's timeliness challenge, concluding that it had insufficiently rebutted DFS's arguments in response to OCC's motion to dismiss, particularly with respect to a legal doctrine that permits a court to review a past agency decision that is outside of the statute of limitations where the agency has "constructively reopened" that decision within the limitations period.[11]

The primary dispute in the case centered around a provision of the NBA stating that OCC may charter entities that are "lawfully entitled to commence the business of banking."[12] OCC, in its own regulations and in the Decision, has interpreted the "business of banking" to involve conducting "one of . . . three core banking functions: [r]eceiving deposits; paying checks; or lending money."[13] DFS claimed that extending an SPNB charter to a non-depository fintech exceeds the scope of OCC's authority under the NBA. OCC argued that, as used in the NBA, the term "business of banking" is ambiguous and, as the regulatory agency tasked with interpreting and implementing the NBA, OCC is entitled to *Chevron* deference in interpreting it.[14]

Judge Marrero disagreed with OCC, concluding that *Chevron* deference did not apply because the meaning of "business of banking" in the NBA "unambiguously requires receiving deposits as an aspect of

the business"[15] and so the OCC was not entitled to any deference in its contrary statutory interpretation. Judge Marrero concluded that, if DFS's characterization of the impact of OCC's interpretation on the dual system of bank regulation were true, "OCC's reading is not so much an 'interpretation' as 'a fundamental revision' of the NBA—essentially exercise of a legislative function by administrative agency fiat."[16] Judge Marrero noted that the "business of banking" formulation dates back to the NBA's passage in 1863, proceeding to consider two dictionary definitions from that time, which listed the receipt of deposits among a group of activities associated with banking. He determined that "the fact that the entries on these lists are separated by 'and' rather than 'or' implies that receiving deposits is not an optional alternative to the other listed activities."[17]

Judge Marrero also noted that he was "not aware of OCC ever having chartered a non-depository entity as a national bank on the strength of the NBA's 'business of banking' clause," and that, instead, where OCC has chartered such entities (in the case of trust banks and bankers' banks), Congress amended the NBA to specifically authorize such chartering.[18] From those examples, Judge Marrero "infer[red] . . . that the amending Congresses understood the NBA's original use of the 'business of banking' phrase to require deposit-receiving."[19]

Finally, Judge Marrero rejected OCC's reliance on certain precedents, including *NationsBank of N.C., N.A.* v. *Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995), in which the Supreme Court determined that the "business of banking" provision was ambiguous as to whether banking included the sale of annuities. He held that "determining the outermost bounds of the phrase 'business of banking' is a different task from determining its threshold requirements," and that "the interpretive clues speak almost unanimously" that "business of banking" as used in the NBA required the taking of deposits.[20] Judge Marrero did, however, grant OCC's motion to dismiss DFS's Tenth Amendment claim, essentially concluding that the thrust of DFS's challenge was that OCC had acted outside of its statutory authorization, not that Congress could not, under the U.S. Constitution, have authorized OCC to grant SPNB charters to non-depository fintechs.[21]

IMPLICATIONS

Judge Marrero's decision is a broad one, leaving no question that he believes OCC acted beyond its delegated powers in issuing the Decision. DFS will likely follow its victory on the motion to dismiss by requesting an injunction against OCC's continued acceptance, consideration, and granting of SPNB charters to non-depository fintechs, and, given the breadth of the decision, appears likely to succeed on that application as well. If it does, OCC can appeal the grant of the injunction, and it will have to look for a contrary view from the Second Circuit Court of Appeals.

At the same time, a similar suit brought by the Conference of State Bank Supervisors is also proceeding in federal district court in Washington, D.C., in front of Judge Dabney Friedrich. OCC's motion to dismiss there is fully briefed, but not yet decided.

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ENDNOTES

1 *Vullo* v. *OCC* (*Vullo II*), No. 18 Civ. 8377 (VM), slip op. at 56 n.14 (S.D.N.Y. May 2, 2019).

2 Office of the Comptroller of the Currency ("OCC"), Exploring Special Purpose National Bank Charters for Fintech Companies 3 (Dec. 2016), https://www.occ.gov/topics/responsible-innovation/comments/pub-special-purpose-nat-bank-charters-fintech.pdf.

3 OCC, Summary of Comments and Explanatory Statement: Special Purpose National Bank Charters for Financial Technology Companies (Mar. 2017), https://www.occ.gov/topics/responsible-innovation/summary-explanatory-statement-fintech-charters.pdf; OCC, Evaluating Charter Applications From Financial Technology Companies (Mar. 2017), https://www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf.

4 786 F.3d 246 (2d Cir. 2015).

5 *See Vullo* v. *OCC* (*Vullo I)*, No. 17-cv-3574, 2017 WL 6512245, at *5, 7 (S.D.N.Y. Dec. 12, 2017).

6 OCC, Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters (July 2018), https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-other-occ-policy-statement-fintech.pdf; OCC, Considering Charter Applications From Financial Technology Companies (July 2018), https://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/pub-considering-charter-apps-from-fin-tech-co.pdf.

7 *Vullo II*, slip op. at 53 (emphasis added).

8 *Id.* at 13, 16, 18, 20-27.

9 *Id.* at 22-23.

10 *Id.* at 26.

11 *See id.* at 28-32. In this case, the earlier agency decision at issue is the OCC's 2003 issuance of 12 C.F.R. § 5.20(e)(1), which interprets the NBA to state that a special purpose bank engages in the "business of banking" when it conducts *at least one* of three core banking activities: receiving deposits, paying checks, and lending money.

12 12 U.S.C. § 27(a).

13 12 C.F.R. § 5.20(e)(1)(i).

14 *Chevron* deference refers to the famed judicial interpretive tool established by *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

15 *Vullo II*, slip op. at 38.

16 *Id.* at 47.

17 *Id.* at 41.

18 *See id.* at 44.

19 *Id.* at 45.

20 *Id.* at 52 (internal quotation marks omitted).

21 *See id.* at 52-56.

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