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Special Purpose Fintech National Bank Charters

OCC Issues Licensing Manual Supplement for Fintech Company Charter Applications

SUMMARY

On July 31, 2018, the Office of the Comptroller of the Currency (OCC) announced that it will consider applications for special purpose national bank charters from financial technology (fintech) companies that are engaged in the business of banking but do not take deposits (Statement).[1] In conjunction with the Statement, the OCC issued a supplement to the Comptroller's Licensing Manual (Licensing Manual) entitled *Considering Charter Applications from Financial Technology Companies* (Licensing Supplement), providing additional detail on the conditions that these special purpose entities will be required to meet.[2]

The OCC's Statement came on the same day that the Treasury Department released its recommendations for facilitating financial innovation.[3] Among other things, the Treasury report urges the OCC to approve "prudent and carefully considered applications for special purpose national bank charters," but recommends that any chartered fintech companies should not be permitted to accept FDIC-insured deposits in order to reduce any potential risk to taxpayers.

BACKGROUND

The OCC's decision was informed by a three-year process of public comment and engagement with a variety of stakeholders. On August 7, 2015, then-Comptroller of the Currency Thomas Curry announced an initiative to develop a comprehensive framework to improve the OCC's ability to identify and understand trends and innovations in the financial services industry, as well as the evolving needs of financial services consumers.[4] On March 31, 2016, the OCC released a white paper setting forth its perspective on supporting responsible innovation in the federal banking system.[5] On December 2, 2016, Comptroller Curry proposed the special purpose national bank charter and stated that the OCC would establish a clear process, criteria and standards for fintech companies to apply for these charters.[6] Concurrently with this announcement, the OCC released a white paper, *Exploring Special Purpose National Bank Charters for Fintech Companies*, and solicited public comments on the proposed charter and related procedures.[7] On March 15, 2017, the OCC issued a draft supplement to the Licensing Manual, *Evaluating Charter Applications from Financial Technology Companies* (Draft Supplement) and again solicited public comment. After reviewing the comments received on both publications, the OCC released the final supplement to the Licensing Manual on July 31, 2018.[8]

CHARTERING AUTHORITY AND SUPPORT FOR RESPONSIBLE INNOVATION

The Statement notes that the National Bank Act grants the OCC broad authority to issue charters for national banks to conduct the "business of banking," and that this authority also extends to special purpose national banks. The "business of banking" includes any of the three core banking functions of (1) receiving deposits, (2) paying checks or (3) lending money. To be eligible for a special purpose national bank charter, an entity must conduct at least one of these three core banking functions.

The Statement reaffirms the OCC's support for responsible innovation in the federal banking system and asserts that chartering qualified fintech companies will promote important public policy objectives, including "consumer choice, economic growth, modernization and competition."[9]

LICENSING SUPPLEMENT

The OCC will use its existing chartering standards and procedures for processing applications submitted by fintech companies. Moreover, fintech companies "will be supervised like similarly situated national banks, including with respect to capital, liquidity and risk management."[10] However, according to the OCC's press release, "new fintech companies that become special purpose national banks will be subject to heightened supervision initially, similar to other de novo banks."[11] The OCC notes that chartered fintech companies must also meet the same regulatory expectations as any other national bank with respect to the promotion of "financial inclusion", although the methods for satisfying these expectations will "depend on the proposed bank's business model, and the types of products, services, or activities it intends to provide."[12]

The Licensing Supplement applies to fintech companies that apply to engage in paying checks or lending money, but not to take deposits, and thus would not be insured by the Federal Deposit Insurance Corporation (FDIC). Applicants that plan to accept deposits would be required to obtain FDIC insurance and apply for a full-service national bank charter, as opposed to a special purpose national bank charter.[13] Similarly, the Supplement does not apply to other types of special purpose banks, like those that engage in fiduciary activities and otherwise meet the requirements of a trust bank.[14]

The procedures for fintech companies outlined in the Licensing Supplement are very similar to those outlined in the Draft Supplement that was released in March 2017.[15] Among the key factors the OCC will consider during its review of fintech charter applications are the qualifications of the company's management and/or directors, the company's business plan (including proposed risk management framework and a risk assessment addressing risks related to, among other things, cybersecurity and fair lending), capital and liquidity (fintech companies will have to meet at least the minimum capital requirements applicable to national banks, but may be subject to higher requirements depending on various factors including off-balance-sheet exposures; they will also be expected to address access to liquidity under stressed conditions in light of their nontraditional funding) and "financial inclusion."[16]

Applications submitted under the Licensing Supplement will also be required to include a contingency plan, which will incorporate elements of the recovery plans and resolution plans that large national banks must file. The requirement for a contingency plan was likely added in response to public comments on the proposal.[17]

The contingency plan must "address significant financial stress that could threaten the viability of the bank" and outline "strategies for restoring the bank's financial strength and options for selling, merging, or liquidating the bank" in the event the recovery strategies are not effective.[18] One of the primary reasons that non-depositary entities must create contingency plans is because the OCC itself would be responsible for resolving a failed special purpose national bank (while the FDIC would be responsible for resolving an insured banking entity). The OCC does not have certain of the resolution powers afforded to the FDIC, and the insolvency provisions under which the resolution would occur has not been tested to the same extent as the statute under which the FDIC resolves banks.[19] A fintech company would be required to develop the contingency plan during its organization phase, which is the period between preliminary conditional approval and final approval of its application.[20] The OCC's final approval will require the bank to implement and adhere to the plan, as a condition to the issuance of its charter.[21] The bank will be expected to review the contingency plan annually and update it as needed; any significant changes will require the non-objection of the appropriate OCC supervisory office.[22]

OBSERVATIONS

The OCC's new Licensing Supplement provides much-awaited clarity on the process by which fintech companies can apply for special purpose national bank charters. However, although the OCC has now established a viable pathway for fintech companies to seek a special purpose charter, several obstacles remain.

First, some state regulators have vowed to challenge the OCC's action. Indeed, on the same day that the Statement and Licensing Supplement were released, the New York Department of Financial Services (NYDFS) issued a statement "strongly oppos[ing]" the OCC's decision, reiterating its position that "a national fintech charter will impose an entirely unjustified federal regulatory scheme on an already fully functional and deeply rooted state regulatory landscape."[23] In addition, following the OCC's initial announcement of a special purpose national bank charter, two suits were filed in federal court. The first was filed in the Southern District of New York on May 12, 2017 by the Superintendent of the NYDFS, alleging that the special purpose national bank charter violates the 10th amendment to the Constitution guaranteeing states' rights. On December 12, 2017, this case was dismissed on the grounds that the court lacked subject matter jurisdiction because the OCC had yet to take any final action that was reviewable by the Court. The second suit was filed in the District Court for the District of Columbia on April 26, 2017 by the Conference of State Bank Supervisors, alleging that the OCC lacks the statutory authority to grant a special purpose national bank fintech charter. On April 30, 2018, this case was also dismissed on the grounds that the CSBS did not have standing to sue because the OCC had yet to officially decide to issue charters to fintech companies. It is likely that either or both of these suits will be refiled once a fintech company files an application, which would likely complicate, make more expensive, and lengthen the process for any would-be fintech special purpose national bank.

Second, it is unclear whether a special purpose national bank charter will be a viable option for certain fintech companies, as some startup or early-stage fintech companies may not be able to satisfy many of the baseline supervisory standards, such as those relating to capital, liquidity, and risk management requirements. Even mature fintech companies may conclude that a special purpose charter does not provide enough of a benefit to justify compliance with a relatively burdensome federal regulatory regime.

In spite of these obstacles, the special purpose national bank charter also provides significant benefits to fintech companies. Fintech companies will benefit from the ability to export interest rates, as well as preemption of certain state licensing and other requirements and state visitorial powers.[24] The charter may also serve as an enhancement to reputation and credibility with customers and the marketplace. In addition, this charter would not subject any company controlling the special purpose national bank to the Bank Holding Company Act, including the Volcker Rule.

The OCC's decision comes at a time of substantially increased interest in bank charters from the fintech sector, which may cause the proposal to have a broader indirect impact by influencing the actions of other agencies and encouraging the development of other types of charters.

At the same time, however, the attractiveness of the special purpose national bank charter will be limited by the bank's inability to take insured deposits. Presumably, a key issue that will be scrutinized in the application process will be the sources of funding for the bank, such as securitizations, parent funding and issuance of debt obligations to third parties.

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ENDNOTES

1 Joseph M. Otting, Comptroller of the Currency, *Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters* (July 31, 2018), *available at* https://www.occ.gov/publications/publications-by-type/other-publications-reports/pub-other-occ-policy-statement-fintech.pdf ("Statement").

2 OCC, *Comptroller's Licensing Manual Supplement: Considering Charter Applications From Financial Technology Companies* (July 31, 2018), *available at* https://www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf ("*Licensing Supplement*").

3 U.S. Department of the Treasury, "A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech and Innovation" (July 31, 2018), at 73 *available at* https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf ("*Treasury Department Report*").

4 Remarks by Thomas J. Curry, Comptroller of the Currency, Before the Federal Home Loan Bank of Chicago (Aug. 7, 2015), *available at* https://www.occ.gov/news-issuances/speeches/2015/pub-speech-2015-111.pdf.

5 OCC, *Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective* (Mar. 31, 2016), *available at* http://occ.gov/publications/publications-by-type/other-publications-reports/pub-responsible-innovation-banking-system-occ-perspective.pdf.

6 Remarks by Thomas J. Curry, Comptroller of the Currency, at the Georgetown University Law Center (Dec. 2, 2016), *available at* https://www.occ.gov/news-issuances/speeches/2016/pub-speech-2016152.pdf.

7 OCC, *Exploring Special Purpose National Bank Charters for Fintech Companies* (Dec. 2, 2016), *available at* https://www.occ.gov/topics/responsible-innovation/comments/special-purpose-national-bank-charters-for-fintech.pdf.

8 OCC, *Comptroller's Licensing Manual Draft Supplement: Evaluating Charter Applications From Financial Technology Companies* (Mar. 15, 2017), *available at* https://www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf.

9 *Statement* at 2.

10 *Statement* at 3.

11 OCC, *OCC Begins Accepting National Bank Charter Applications from Financial Technology Companies* (July 31, 2018), *available at* https://occ.gov/news-issuances/news-releases/2018/nr-occ-2018-74.html.

12 *Licensing Supplement* at 10.

13 *Licensing Supplement* at 3.

14 *Licensing Supplement* at 2.

15 For a full analysis of the procedures outlined in the Draft Supplement, please see Sullivan & Cromwell's March 19, 2017 memo, "Office of the Comptroller of the Currency Issues Draft Licensing Manual Supplement for FinTech Companies," *available at* https://www.sullcrom.com/office-of-the-comptroller-of-the-currency-issues-draft-licensing-manual-supplement-for-fintech-companies.

16 *Licensing Supplement*.

ENDNOTES (CONTINUED)

17 A comment letter submitted by The Clearing House noted that special purpose national banks "may by their very nature pose greater risks to the deposit insurance fund given that the nature of innovation, as well as non-diversification, is inherently risky," and suggesting that the OCC and FDIC reach a "common understanding" on this point before a final announcement by the OCC. The Clearing House, Comment Letter re: Exploring Special Purpose National Bank Charters for Fintech Companies, at 7 (Jan. 17, 2017), *available at* https://www.theclearinghouse.org/-/media/tch/documents/tch%20weekly/2017/20170117_joint_trades_occ_fintech_charter_comment_letter.pdf?la=en.

18 *Licensing Supplement* at 10.

19 OCC, Receiverships for Uninsured National Banks – Final Rule, (Dec. 20, 2016), *available at* https://www.gpo.gov/fdsys/pkg/FR-2016-12-20/pdf/2016-30666.pdf.

20 *Licensing Supplement* at 12.

21 *Licensing Supplement* at 10.

22 *Licensing Supplement* at 10.

23 NYDFS, Statement by DFS Superintendent Maria T. Vullo on Treasury's Endorsement of Regulatory Sandboxes for Fintech Companies and the OCC's Decision to Accept Fintech Charter Applications, (July 31, 2018), *available at* https://www.dfs.ny.gov/about/statements/st1807311.htm.

24 12 U.S.C. §85. While fintech companies operating under a special purpose national bank charter would presumably be entitled to the benefits of preemption under Section 85 of the National Bank Act, there is a question of whether purchasers of debt originated by special purpose national banks would be entitled to these same benefits. See *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2nd Cir. 2015). The Treasury Department Report urges Congress to answer this question by codifying the ability of banks to buy and sell validly made loans without the risk of conflicting with state interest-rate limits.

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