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OCC Opens Door for Fintech National Banks

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Following the Office of the Comptroller of Currency's (the "OCC") July issuance of a policy statement[1] and supplement to its licensing manual[2] relating to special purpose national charters for non-deposit-taking financial technology ("fintech") companies that are engaged in the business of banking, as well as the Treasury Department's support in its July report,[3] fintech firms across the country are looking into what this process entails and the potential benefits accompanying a special purpose national bank charter.

The special purpose fintech charter is designed to incentivize innovation by allowing fintech firms to operate on a national scale, like other national banks, without having to obtain 50 state licenses and navigate each state's unique regulatory scheme. As Comptroller of the Currency Joseph M. Otting stated, "Companies that provide banking services in innovative ways deserve the opportunity to pursue that business on a national scale as a federally chartered, regulated bank."

This Alert first provides a brief overview of the OCC's authority and policy for issuing national charters. It then lays out the four phases of the national charter application process. It concludes with a discussion of current industry developments and considerations.

OCC Authority and Policy for Issuing National Charters

The National Bank Act (the "NBA") authorizes the OCC to regulate and supervise national banks. Under the NBA, the OCC may grant a national charter to an association of persons to carry on the "business of banking."[4] Under OCC rules, the three "core" banking activities are receiving deposits, paying checks and lending money.[5]

The OCC's fintech initiative distinguishes between the activities of a special purpose national bank and a full service national bank. While a special purpose national bank must conduct at least one of the three "core" activities, it likely would be limited to either check-paying or money-lending, or both, because a full service national bank charter already addresses deposit-receiving activities, which are insured by the Federal Deposit Insurance Corporation (the "FDIC") under the Federal Deposit Insurance Act. Paying checks and lending money would not be FDIC-insured and therefore pose less of a risk to the financial system.

Fintech companies that receive a special purpose national bank charter will be supervised like similarly situated national banks, to include capital, liquidity, and financial inclusion commitments, as appropriate, and new fintech companies that receive a special purpose national bank charter will become subject to heightened supervision initially, similar to other *de novo* banks. In the event that a national bank fails, it will be unwound by the OCC.

[1] Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters, Office of the Comptroller of the Currency (July 31, 2018), *available at* https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/pub-other-occ-policy-statement-fintech.pdf.
[2] Considering Charter Applications Form Financial Technology Companies, Comptroller's Licensing Manual Supplement (July 2018), *available at* https://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-considering-charter-applications-fintech.pdf.
[3] A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation, U.S. Department of the Treasury (July 2018), *available at*https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf.
[4] 12 U.S.C. § 24 (Seventh).
[5] *See* 12 C.F.R. § 5.20(e)(1).

Application Process for Special Purpose National Bank Charter

The application process for fintech companies seeking a special purpose national bank charter (a "SPNB Charter") from the OCC includes four phases—Pre-filing, Filing, Review and Decision—discussed in further detail below.

Phase 1: Pre-filing Phase. *Potential applicants engage with the OCC in formal and informal meetings to discuss the proposal, the chartering process and application requirements.*

A fintech company interested in an SPNB Charter should contact the OCC's Office of Innovation. After an initial dialogue, the Office of Innovation may arrange further discussions with appropriate OCC staff, including the Licensing Department, to give the company an opportunity to understand the application process, explain its proposal and reasons for seeking a SPNB Charter and become acquainted with the bank regulatory environment.

If the company decides to pursue a SPNB Charter, the Licensing Department will determine whether one or more additional meetings will be scheduled with OCC. For additional meetings, organizers should be prepared to discuss:

- the proposed bank's business plan, including a description of the proposed activities;
- the underlying marketing analysis supporting the business plan;
- the capital and liquidity needed to support the business plan;
- a contingency plan to remain viable under significant financial stress; and
- how it proposes to demonstrate a commitment to financial inclusion.

Following additional meetings, the Licensing Department will determine whether the company should submit a draft application before filing a formal application.

Phase 2: Filing Phase. *Applicants submit SPNB Charter application to the OCC for review.*

The filing procedures for an SPNB Charter are substantially the same as those for any other national bank charter. A key part of the filing is an extensive business plan proposal. The application is published and made available to the public for comment.

Phase 3: Review Phase. *The OCC reviews the application to assess the safety and soundness of the proposed SPNB Chartered-bank.*

The OCC will consider several factors in its review of the application, including whether the proposed bank:

- has a reasonable chance of success;
- will be operated in a safe and sound manner;
- will provide fair access to financial services;
- will promote fair treatment of customers;
- will ensure compliance with laws and regulations;
- can reasonably be expected to achieve and maintain profitability; and
- will foster healthy competition.

The OCC will thoroughly review the application, including the business model and proposed risk profile, and consider whether the applicant has adequate capital and liquidity to support the projected volume and business and whether the applicant's organizers and management have appropriate skills and experience. Key considerations of the OCC's review include:

- Organizers, Management and Directors
- Business Plan
- Capital and Liquidity
- Financial Inclusion
- Contingency Planning

Phase 4: Decision Phase. *A SPNB Charter application must obtain both preliminary conditional approval and final approval from the OCC.*

The decision phase includes three stages:

- Stage 1: Preliminary Conditional Approval Stage: The OCC imposes requirements and conditions for receiving a SPNB Charter;
- Stage 2: Organization Stage: The bank raises capital and prepares for opening; and
- Stage 3: Final Approval Stage: The OCC will issue final approval if it determines that all key phases of organizing the bank have been completed, all requirements and conditions for final approval have been met and the organizers have received any other necessary regulatory approvals.

The OCC will lay out conditions for the approval of a SPNB Charter, which may be specific to SPNB Chartered-banks or unique to an applicant and may address a variety of issues, such as:

- guaranteeing maintenance of minimum capital levels commensurate with the prospective risk of the bank's business plan;
- ensuring that the bank does not significantly deviate from the business model proposed in its application without obtaining the OCC's prior non-objection;
- developing a contingency plan that includes options to sell itself, wind down or merge with a nonbank affiliate, if necessary, since SPNB Chartered-banks are not backed by the FDIC;
- requiring the bank to demonstrate a commitment to financial inclusion under the Community Reinvestment Act or other statutes that apply by their terms only to FDIC-insured banks;
- submitting to periodic assessments and ongoing supervision by the OCC under a scheduled supervisory cycle, including on-site examination and periodic off-site monitoring.

Current Industry Developments and Considerations

Industry Reaction. Industry hopes are high that fintech charters will open new opportunities for technology companies in one of the most heavily regulated sectors. Following the OCC's announcement of its intent to proceed with fintech charters, fintech companies have shown interest in exploring this new space, both publicly and privately.

Legal Challenges. The new fintech charter is not without critics. State regulators are wary of relinquishing oversight over such a quickly adapting field to a regulator that has not historically focused on the technology industry. Already various state regulators have sued the OCC to prevent it from issuing charters to fintech companies. A 2017 lawsuit by the New York Department of Financial Services (the "NYFDS") claiming that awarding national bank charters to online lenders and payment companies was unconstitutional and put vulnerable consumers at risk was dismissed on standing and ripeness grounds because the OCC had not reached a final decision on whether to grant special purpose charters to fintech firms. Another lawsuit by the Conference of State Bank Supervisors against the OCC was dismissed by the federal district court for the District of Columbia in late April on similar standing and ripeness grounds.

On September 14, 2018, the NYFDS filed a suit against the OCC and Joseph Otting in the SDNY challenging the OCC's decision to begin accepting from, and grant SPNB Charters to, "a boundless class of undefined" fintech companies "in connection with an unidentified and sweeping array of commercial ventures never before authorized or regulated by the OCC."[6] The NYFDS cited specific risks of SPNB Charters, including "weakening regulatory controls on usury, payday loans, and other predatory lending practices; consolidating multiple non-depository business lines under a single federal charter thus creating even more institutions that are "too big to fail"; creating an unlevel and unfair playing field . . . ; and creating competitive advantages for large, well-capitalized "fintech" firms, which can overwhelm smaller market players and thereby stunt rather than foster innovation in financial products and services."[7] The pending lawsuit creates uncertainty over the legal status of the SPNB Charters.

Collaboration with the Federal Reserve. Whether, and under what circumstances, the Federal Reserve will allow SPNB Chartered-banks direct access to central bank lending and to the U.S. payment systems remains unresolved. Currently, these fintech firms can access the U.S. payments systems only through partnerships with banks, and direct access would remove the middle man and lower costs.

Conclusion

Technological advances and banking services are colliding, and, as a consequence, banks are evolving. While regulatory compliance and legal challenges may diminish ardor for the national bank alternative, the fintech national bank charter holds the promise of delivering lower costs and improved efficiencies in a safe and sound environment that protects consumers. For organizations that find the national bank charter unattractive, state regulation and bank/non-bank collaborations remain viable alternatives, with state regulators likely to coalesce into a less burdensome framework designed to compete with a national bank platform.

For further information about how the issues described in this Alert may impact your interests, please contact Mark Nuccio, Gideon Blatt or Stephanie Ragland or your regular Ropes & Gray contact.

[6] *Vullo v. Office of the Comptroller of the Currency et al.*, case number 1:18-cv-08377, in the U.S. District Court for the Southern District of New York at 1.
[7] *Id.*