

Client Alert

August 2018

FinTech . . . or is it?

The Office of the Comptroller of the Currency (“OCC”) yesterday announced that it is now accepting applications for national bank charters from nondepository banking institutions (i.e. entities that lend money or cash checks, or both).¹ The announcement was coordinated with the US Treasury Department (“Treasury”), which simultaneously released a report addressed to the administration in support of the regulation of nonbank financial entities and financial innovation.²

The OCC

In August 2015, the OCC began meeting with financial technology (“FinTech”) companies, banks, community and consumer groups, academics, and other regulators to gain a better understanding of financial innovation.³ In October 2016, the OCC established the Office of Innovation to serve as the central point of contact and clearinghouse for requests and information related to innovation.⁴ Additional FinTech guidance was published by the OCC in December 2016⁵ and March 2017.⁶ The gist of all this guidance was that the OCC (i) believed that a special purpose FinTech national charter (“FinTech Charter”) could be in the public interest and (ii) believed that it had the authority to issue such a charter, so long as the entity conducted at least one of three functions: receiving deposits, paying checks, or lending money.

Further FinTech Charter developments then became bogged down by two events: changeover at the head of the OCC⁷ and two lawsuits challenging the OCC’s authority to issue a FinTech Charter. The Conference of State Bank Supervisors (“CSBS”) was the first to strike, filing a complaint in the US District Court of D.C. on April 26, 2017 asking the court to issue a declaratory judgment that the OCC lacks the authority to issue FinTech Charters.⁸ The New York Department of Financial Services (“NY DFS”) filed its own, similar lawsuit in the Southern District of New York on May 12, 2017.⁹ Because the OCC did not actually issue a FinTech Charter, both cases were dismissed as moot, the NY DFS’ case on December 12, 2017,¹⁰ and the CSBS’ case on April 30, 2018.¹¹

¹ [OCC NR 2018-74, OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies \(July 31, 2018\)](#).

² [Treasury Releases Report on Nonbank Financials, Fintech, and Innovation](#).

³ [OCC NR 2015-111, Comptroller Discusses Responsible Innovation, Risk Management \(Aug. 7, 2015\)](#).

⁴ [OCC NR 2016-135, OCC Issues Responsible Innovation Framework \(Oct. 26, 2016\)](#).

⁵ [OCC NR 2016-152, OCC to Consider FinTech Charter Applications, Seeks Comment \(Dec. 2, 2016\)](#).

⁶ [OCC NR 2017-31, OCC Issues Draft Licensing Manual Supplement for Evaluating Charter Applications from Financial Technology Companies \(Mar. 15, 2017\)](#).

⁷ Keith Noreika took over from Thomas Curry as the Acting Comptroller of the Currency on May 5, 2017. Mr. Noreika, in turn, was succeeded by Joseph Otting when he was sworn in as the Comptroller of the Currency on November 27, 2017.

⁸ [CSBS Complaint Against the OCC Concerning a Federal FinTech Charter \(Apr. 26, 2017\)](#).

⁹ [Statement by Superintendent Maria T. Vullo on the Department of Financial Services Lawsuit Challenging the OCC’s Unauthorized Decision to Grant “Special Purpose” National Bank Charters to Undefined “FinTech” Companies \(May 12, 2017\)](#).

¹⁰ A copy of the NY DFS dismissal is available [here](#).

Yesterday's press release from the OCC revitalizes the FinTech Charter concept, announcing that the OCC is officially open to entertaining charter applications from entities whose business plan includes either lending money or cashing checks¹² (or both), but not accepting deposits. The materials released with the press release tread some old ground: FinTech Charters could benefit the public interest and the OCC has the authority to issue FinTech Charters. However, the materials also contain some explicit guidance for FinTech Charters that will not accept deposits (what the OCC is calling special purpose national banks or "SPNB"):

1. The SPNB will be held to the same supervisory standards as other OCC charters.
2. The process for granting a SPNB charter will mirror the established *de novo* chartering process.
3. SPNBs will have to abide by Community Reinvestment Act-like requirements.
4. The OCC's approval of an SPNB charter will be conditioned on (i) the SPNB maintaining higher than normal capital requirements using bank capital ratios as proxies; (ii) the SPNB's parent company committing to provide contingent liquidity support to the SPNB; and (iii) OCC's approval of a contingency plan for the SPNB.

The Implications

A nondepository national bank charter could be monumentous, but perhaps not in the way most suspect.

Despite being characterized as a "FinTech" development, the greatest impact of the SPNB charter will be on traditional non-bank financial actors that heretofore have operated under state law, including consumer lenders, money service businesses, money transmitters, check cashers, and other similar types of financial entities.

- The state law regimes that these actors operate under would generally be preempted by a national bank charter.
- Many of these types of entities are supervised and regulated by the Consumer Financial Protection Bureau ("CFPB"). If they were to obtain a national bank charter and maintain total consolidated assets under \$10 billion, their regulator would change from the CFPB to the OCC.
- The customers of these non-bank financial actors tend to be the "unbanked" or the "underbanked." Bringing them into the national banking system through an SPNB could help connect them with the more traditional banking system.
- The Community Reinvestment Act ("CRA") does not currently apply to non-bank financial actors. However, turning them into SPNBs could dramatically increase the demand and price for CRA compliant assets. Small Business Investment Company funds, funding for Community Development Financial Institutions, and other similar business opportunities could blow up and have material community impacts.¹³
- Nothing in the guidance requires that nondepository entities enter the national banking system through the *de novo* route. Why couldn't a check casher, say, acquire an national bank charter through a merger and

¹¹ A copy of the CSBS dismissal is available [here](#).

¹² Of note to money transmitters and money service businesses, the OCC has signaled a willingness to interpret the phrase "cash checks" broadly ("Similarly, issuing debit cards or engaging in other means of facilitating payments electronically are the modern equivalent of paying checks.").

¹³ The United States Government Accountability Office ("GAO") released an interesting report on CRA and alternative financial services in February 2018. See [here](#).

acquisition or stock purchase agreement?¹⁴ Such a development could increase the value of a community bank charter, especially of interest to those charters looking to sell themselves.

- SPNBs will obtain an account with a Federal Reserve bank, enabling them to clear payments directly through the Federal Reserve system.
- As of June 30, 2018, the OCC supervised 901 national banks.¹⁵ As of July 31, 2018, there were 25,408 money services businesses registered with Financial Crimes Enforcement Network (“FinCEN”).¹⁶ If even a fraction of the traditional non-bank financial actors converted to national banks, the size, culture, and function of the OCC could change dramatically.
- Embracing the SPNB charter could effectively transfer state control and regulation over non-bank financial actors to the OCC.

The implications of the OCC’s guidance released yesterday is less dire for community banks than many may be fearing. Simply put, SPNBs, because they do not accept deposits, are not direct competitors of deposit-taking commercial banks. The trend in the financial services space is to provide your customers with more financial products, not fewer. Because SPNBs will not be able to provide customers with a key financial product (deposits) their ability to take customers away from community banks will be limited. Additionally, without recourse to the lower cost funding afforded by deposits, SPNBs will have a difficult time competing with community banks on loan pricing. The potential battleground between SPNBs and community banks would be the interchange income associated with payments. However, such lucrative sources of bank income is already under siege from Paypal, Google, Apple and others. Marketplace lenders may choose to forgo the burdens of additional regulation and not seek an SPNB charter, especially those marketplace lenders that already have entrenched and working relationships with banks. The first group at risk from an SPNB charter might be those state banking regulators who would lose assessments related to regulating some of the larger non-bank banking actors.¹⁷ Additionally, SPNBs might have a hard time adjusting their culture and risk management programs to conform with the OCC’s requirements.

The issuance of the first SPNB charter will no doubt be challenged in court, perhaps by the same groups that challenged the OCC in court 2017. While an analysis of the legal merits of such a challenge are beyond the scope of this alert, the challenge itself would be made moot if Congress were to amend the National Bank Act to make the OCC’s authority in this respect clear. The question of consolidating charters and regulatory agencies has been a consistent theme over the course of the past 25 years. Though it may not appear so at first blush, the SPNB charter could be a major step in that direction.

Author

Carleton Goss

cgoss@huntonak.com

© 2018 Hunton Andrews Kurth LLP. Attorney advertising materials. These materials have been prepared for informational purposes only and are not legal advice. This information is not intended to create an attorney-client or similar relationship. Please do not send us confidential information. Past successes cannot be an assurance of future success. Whether you need legal services and which lawyer you select are important decisions that should not be based solely upon these materials.

¹⁴ This transaction could be structured as an acquisition of the check casher by a national bank as an operating subsidiary and then a merger of the check casher with and up into the national bank with the check casher surviving under [12 USC. § 215a-3](#).

¹⁵ See [here](#).

¹⁶ See [here](#).

¹⁷ Note that the two plaintiffs in the FinTech Charter litigation were state banking regulators (the CSBS and the NY DFS), not community bank industry groups.