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# To charter or not to charter? Considerations for FinTech companies seeking to apply for an OCC special purpose national bank charter

The Office of the Comptroller of the Currency ('OCC') - the chartering authority and primary regulator of national banks in the US - recently issued a policy statement announcing that it will begin accepting applications for special purpose national bank ('SPNB') charters from non-depository FinTech companies ('the Policy Statement')<sup>1</sup>. The OCC also provided a supplement to its Licensing Manual, addressing such charter applications by FinTech companies ('the Licensing Supplement')<sup>2</sup>. These moves by the OCC, coming after nearly two years of debate and resistance by state regulators and community banks, build on a white paper released in December 2016 ('the White Paper')<sup>3</sup>, the March 2017 draft supplement to the OCC Licensing Manual ('the Draft Supplement')<sup>4</sup>, and comments submitted by the public in response to both.

The financial services industry has experienced significant change over the past five years, with the proliferation of technology-driven non-bank companies offering access to a variety of new financial products and services or new approaches to traditional financial products or services. In the Policy Statement, the OCC reiterated its support for 'responsible innovation' and said that the SPNB charter would 'level the playing field with regulated institutions and help ensure [FinTech companies] operate in a safe and sound manner'<sup>5</sup>. The OCC further stated that FinTech companies that receive an SPNB charter would be subject to the same high standards for safety and soundness that all national banks must meet. According to the OCC, a FinTech company with an SPNB charter will be supervised like similarly situated national banks, including requirements for capital, liquidity, risk management, financial inclusion and contingency planning. These requirements, taken together with the extensive application process laid out by the OCC and the heightened supervision that an SPNB will initially face, may, as a practical matter, be at odds with the OCC's stated intent of supporting innovation. It remains to be seen whether the OCC's chartering process for FinTech companies will present a viable alternative to the state-by-state licensing approach currently utilised by many FinTech companies to conduct business on a multi-state or national level or the bank partnership model utilised by others.

Alan W Avery, Todd Beauchamp, Loyal Horsley, Pia Naib, and Charles Weinstein, of Latham & Watkins LLP, look at the chartering process and approval standards and some open questions and practical considerations for FinTech companies contemplating the OCC SPNB charter.



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#### **OCC legal authority and status of SPNBs**

Under the National Bank Act of 1863<sup>6</sup>, the OCC has the authority to grant charters for national banks, including the authority to grant charters for SPNBs. Historically, the most common types of SPNBs have been trust banks and credit card banks. The 'special purpose' for which a bank can be chartered is not legally limited, so long as the company engages in fiduciary activities or conducts one of the three core banking functions identified in the National Bank Act: receiving deposits, paying cheques or lending money. While the term 'special purpose national bank' is used more broadly in other OCC materials, the Licensing Supplement uses the term 'SPNB' to refer specifically to a national bank that engages in a limited range of banking activities and does not take deposits within the meaning of the Federal Deposit Insurance Act of 1950<sup>7</sup>. According to the OCC, the National Bank Act allows the OCC the flexibility to grant special purpose charters to FinTech companies that engage in paying cheques and/or lending money. As such, those entities that would apply for this SPNB charter would not accept deposits and would therefore not be insured by the Federal Deposit Insurance Corporation. An important question regarding SPNBs is whether such institutions would be considered 'banks' for purposes of the Bank Holding Company Act of 1956, as amended ('the BHC Act')<sup>8</sup>. Under the BHC Act, any company that controls a bank is subject to supervision and

regulation by the Board of Governors of the Federal Reserve System ('Federal Reserve') is also subject to a range of statutory and regulatory requirements, including restrictions on non-banking activities. Other forms of SPNBs chartered by the OCC are generally excluded from the definition of 'bank' under the BHC Act, and it appears that an SPNB would similarly not be considered a bank for BHC Act purposes. Accordingly, FinTech companies considering an SPNB charter would probably not be impacted by the BHC Act's restrictions and prohibitions on banks that are subject to the requirements of the BHC Act.

#### **Chartering process**

As with anyone seeking a national bank charter, the basis for all chartering procedures for FinTech companies seeking SPNB charters is the Comptroller's Licensing Manual. While the Licensing Supplement provides more specific guidance on how the process will differ for FinTech companies, the general steps that a FinTech company would take to apply for the SPNB charter are the same as those for any aspiring national bank, and include: (i) pre-filing communications with the OCC; (ii) filing of the application; (iii) conditional approval/organisational phase; and (iv) final approval. The biggest difference is that the main point of contact will be the OCC Office of Innovation. Upon final approval, the OCC will issue a charter for the bank, which allows it to begin conducting banking business, subject to the ongoing supervision and oversight of the OCC.

#### **OCC's decision-making process for SPNBs**

The OCC follows several general principles in evaluating all national bank charter applications, including applications seeking SPNB charters. In the Licensing Supplement, the OCC outlines the 'key considerations' in its decision of whether to grant an SPNB charter; some are specific to the SPNB charter and others are generally applicable to any national bank charter applicant. In coming to a decision, the OCC will consider whether the proposed bank: (i) has a reasonable chance of success; (ii) will be operated in a safe and sound manner; (iii) will provide fair access to financial services; (iv) will promote fair treatment of customers; and (v) will ensure compliance with laws and regulations.

In determining whether an applicant has met the foregoing considerations, the OCC will also take into account the following factors:

#### **Organisers, management and directors**

As with any national bank charter application, the organisers, proposed managers and board of directors are critical. For SPNBs, however, the OCC will look for additional technology-focused experience, rather than just traditional banking experience.

#### **Business plan**

The business plan must provide a detailed description of the SPNB's proposed activities, and financial



projections under both normal and stressed conditions, as well as a clear, realistic plan to accomplish the stated goals, while serving the community and managing risk. As part of this, the business plan must also include a description of the proposed risk management framework and a detailed risk assessment that is tailored to the proposed activities and demonstrates an understanding of the various inherent risks.

#### **Capital and liquidity**

An SPNB must maintain capital and liquidity reserves to ensure its safety and soundness, as well as that of the US financial system: generally, it will probably have to maintain higher reserves than the usual *de novo* bank<sup>9</sup>. As the OCC has not chartered this type of entity before, the capital and liquidity requirements will be tailored to the institution and commensurate with the risk and complexity of the proposed activities.

#### **Financial inclusion**

The Community Reinvestment Act of 1977 ('the CRA')<sup>10</sup> and its implementing regulations ensure that all insured depository institutions provide support for their underserved communities. SPNBs will not have deposit insurance and would thus not be subject to the CRA's requirements. To ensure that SPNBs provide fair access to underserved communities, the OCC will require an SPNB to demonstrate a commitment to 'financial inclusion' in its application. Unlike traditional banks, an

SPNB is unlikely to be tied to a physical location, which provides some flexibility in determining which 'community' the SPNB wants to focus on serving and how it will do so effectively. Prior to final approval, the OCC will review the SPNB's policies and procedures to determine whether the SPNB will meet its stated financial inclusion objectives effectively. If not, the OCC may impose certain conditions as part of its final approval.

Some consumer groups have criticised the OCC's approach to financial inclusion requirements in the Licensing Supplement, noting that much of the detailed language regarding financial inclusion expectations and requirements contained in the Draft Supplement was not included in the final Licensing Supplement. To those critics, the deletions signal a lessened emphasis on financial inclusion by the OCC. The OCC has stated that the deletions were intended to give it the flexibility to tailor the financial inclusion requirements appropriately to fit the size, scope and nature of each SPNB applicant.

#### **Contingency planning**

Unlike a traditional *de novo* bank, an SPNB must develop a 'contingency plan' outlining how the SPNB would either restore financial stability or resolve the bank in the event of severe financial distress. The closest analogue is the 'living will' that systemically important financial institutions are required to develop to help to avoid systemic chaos and failures in the event of

one institution's financial distress".

#### **Objections by state regulators**

In the wake of the release of the White Paper in early 2017, the Conference of State Bank Supervisors ('CSBS') and the New York State Department of Financial Services ('NYSDFS') Superintendent Maria T Vullo each separately sued the OCC and then-Acting Comptroller Keith Norieka, in the US District Court of the District of Columbia and the US District Court of the Southern District of New York respectively, alleging that granting the proposed charter was outside the scope of the OCC's statutory authority and would have harmful consequences for the US financial system. Both suits were dismissed by the courts, primarily on the ground that the claims were premature because the OCC had not taken any official action on the chartering process. However, in the order dismissing the CSBS' case, the US District Court of the District of Columbia noted that the potential injuries that the CSBS alleged would be contingent upon the OCC issuing the Licensing Supplement and granting an SPNB charter to a FinTech company<sup>12</sup>. The OCC's decision to move forward with the FinTech chartering process was promptly denounced by both the CSBS and the NYSDFS, with CSBS President and Chief Executive Officer John W Ryan characterising the OCC FinTech charter as "a regulatory train wreck in the making"<sup>13</sup>, and Superintendent Vullo expressing NYSDFS's strong opposition to the OCC's FinTech charter on the basis that "a national fintech charter will



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impose an entirely unjustified federal regulatory scheme on an already fully functional and deeply rooted state regulatory landscape<sup>14</sup>.” On 12 September 2018, the CSBS announced that it intends to sue the OCC again over the FinTech charter, at a time that it deems appropriate. On 14 September 2018, Superintendent Vullo sued the OCC and Comptroller Joseph Otting in the US District Court of the Southern District of New York, again seeking to block the OCC from taking further action to implement the chartering process. The 2018 NYSDFS complaint, which is largely identical to the 2017 dismissed complaint, restates the NYSDFS’s principal legal argument that the OCC has exceeded its statutory authority and claims that the matter is now ripe to be heard by a court.

#### **Practical considerations for FinTech company SPNB applicants**

A number of important questions and issues remain regarding the OCC’s SPNB charter alternative, which FinTech companies will need to consider when evaluating whether it provides a viable regulatory approach.

#### **Federal Reserve payments system access**

An important federal banking law question, particularly for any SPNB seeking to engage in payment-related activities, is whether SPNBs will be permitted to establish accounts with a Federal Reserve Bank for purposes of obtaining payments services. Under the Federal Reserve Act of 1913<sup>15</sup>, only insured depository institutions and other specific types of institutions are permitted to establish accounts with a Federal Reserve Bank for purposes of accessing the Federal Reserve payment system, but the Federal Reserve has discretion to determine which other types of institutions may have Federal Reserve accounts. In its report on financial innovation, released on the same day as the Policy Statement and the Licensing Supplement, the Treasury Department encouraged the Federal Reserve to determine whether SPNBs will have access to the Federal Reserve payment system<sup>16</sup>.

#### **Federal Reserve discount window access**

Similarly, it is not clear whether SPNBs would have access to the Federal Reserve’s discount window. The ability to borrow from the discount window provides access to a very low-cost source of funding, which could be very important for lending-focused SPNBs, such as marketplace lenders.

#### **Litigation risk**

As discussed above, the NYSDFS Superintendent has sued the OCC and the Comptroller to block the OCC’s efforts to issue SPNB charters to FinTech companies, and the CSBS has stated that it intends to sue the OCC, too. While the OCC is likely to prevail on the merits in these suits, the legal process to resolve these actions could take a long time, and the status of the SPNB charter (and any SPNBs that may be chartered) would be in question until such cases are resolved. Potential applicants must take into consideration the uncertainty as to the timing and outcome of the litigation when assessing whether to pursue a SPNB charter.

#### **Extensive regulatory requirements**

The same high standards that are applicable to all national banks will be applicable to any FinTech company with an SPNB charter. SPNBs will be supervised in the same way as similarly situated national banks and will be subject to similar regulatory requirements, outlined above. The OCC has also stated that SPNBs will be subject to heightened supervision initially, as for other *de novo* national banks. These requirements and expectations may make it difficult for many FinTech companies, particularly start-ups, to get OCC approval.

Additionally, the OCC has not explicitly defined some requirements and will, instead, determine how the SPNB will comply on a case-by-case basis, depending on the specific nature of the applicant’s business. This means that a FinTech company will have to invest significant time and resources in the SPNB charter application process

prior to knowing what all of its specific regulatory requirements will be.

#### **Comparison with alternative regulatory approaches**

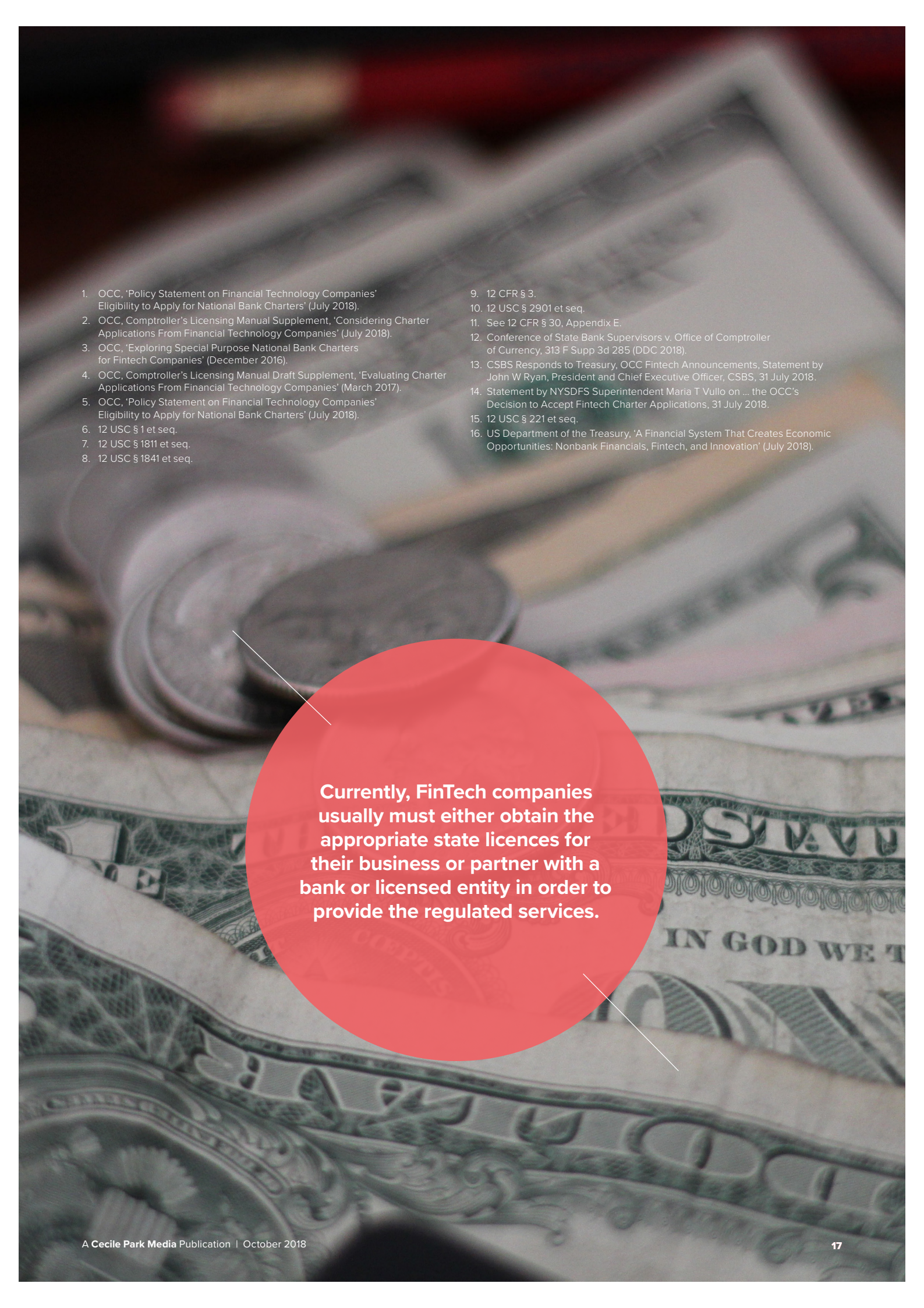
Currently, FinTech companies usually must either obtain the appropriate state licences for their business (i.e. money transmitter licences or lending licences) or partner with a bank or licensed entity in order to provide the regulated services. A threshold question for FinTech companies who are considering an SPNB charter is how this new regulatory alternative compares with the current options. The SPNB chartering process is currently fraught with uncertainty and may end up being more costly and time consuming than a 50-state licensing or bank partnership solution. Potential applicants would need to weigh those potential additional cost and time considerations against the potential long-term benefits that the SPNB charter might provide for their particular business model.

#### **Conclusion**

While the OCC’s intention in providing the SPNB charter is, ostensibly, to support and encourage innovation that can improve and expand access to financial services, the significant (and in some cases, uncertain) regulatory requirements, and open hostility from state regulators, may impede that vision. The high initial expectations and ongoing burden associated with the SPNB charter, coupled with the open questions and uncertainty discussed above, are likely to mean that the pool of potential candidates for an SPNB charter will be limited to a discrete number of well-resourced and sophisticated groups with sufficiently experienced personnel.

Of these, some will probably already have regulatory compliance structures in place and fail to see a compelling benefit in transitioning to an SPNB charter. For the rest, the question will be whether they have the ability and desire to make the required investments in the face of uncertainty in terms of timelines, probability of success, and potential impact on their proposed activities.



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1. OCC, 'Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters' (July 2018).
  2. OCC, Comptroller's Licensing Manual Supplement, 'Considering Charter Applications From Financial Technology Companies' (July 2018).
  3. OCC, 'Exploring Special Purpose National Bank Charters for Fintech Companies' (December 2016).
  4. OCC, Comptroller's Licensing Manual Draft Supplement, 'Evaluating Charter Applications From Financial Technology Companies' (March 2017).
  5. OCC, 'Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters' (July 2018).
  6. 12 USC § 1 et seq.
  7. 12 USC § 1811 et seq.
  8. 12 USC § 1841 et seq.
  9. 12 CFR § 3.
  10. 12 USC § 2901 et seq.
  11. See 12 CFR § 30, Appendix E.
  12. Conference of State Bank Supervisors v. Office of Comptroller of Currency, 313 F Supp 3d 285 (DDC 2018).
  13. CSBS Responds to Treasury, OCC Fintech Announcements, Statement by John W Ryan, President and Chief Executive Officer, CSBS, 31 July 2018.
  14. Statement by NYSDFS Superintendent Maria T Vullo on ... the OCC's Decision to Accept Fintech Charter Applications, 31 July 2018.
  15. 12 USC § 221 et seq.
  16. US Department of the Treasury, 'A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation' (July 2018).

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