

OCC to Make Available Special Purpose National Bank Charters to Fintech Companies

While many fintech companies will welcome the regulatory approach, banks and state regulators have some concerns.

In a long-awaited move aimed at establishing some clarity around the regulatory framework for companies involved in offering innovative financial technology products and services, the Office of the Comptroller of the Currency (OCC) — which is the chartering authority and primary prudential regulator and supervisor of national banks — recently announced that it would move forward with a plan to allow certain financial technology (fintech) companies to become chartered under federal banking law as special purpose national banks.¹ The OCC's announcement was accompanied by a white paper entitled "Exploring Special Purpose National Bank Charters for Fintech Companies" (the White Paper), which discusses the proposal and seeks public comments and feedback by January 15, 2017.² Integrating the fintech industry into the US bank regulatory regime has proven difficult because of the wide variety of companies operating in this area, including: marketplace lenders providing consumer loans, as well as companies that offer payment-related services, engage in digital currencies and distributed ledger technology, or provide financial planning and wealth management products. From the OCC's perspective, providing fintech companies with the option to obtain a federal charter is in the public interest and is important to the dual state/federal banking system in the US and to promoting responsible innovation within the federal banking system.

This *Client Alert* provides an overview of the OCC's White Paper and discusses the initial reactions of various financial services industry participants.

Background

The financial services industry has experienced significant change over the past five years with the proliferation of technology-driven nonbank companies seeking to offer access to a variety of new types of financial products and services or new approaches to traditional financial products or services. In his remarks describing the White Paper, Comptroller of the Currency, Thomas J. Curry, noted that there are more than 4,000 fintech companies operating in the United States and United Kingdom.³ Given that many of these companies operate outside their respective federal bank regulatory systems, the OCC's decision to offer fintech companies the opportunity to become regulated as national banks under special purpose charters would, according to the OCC, increase consumer protection and financial inclusion, promote responsible innovation and economic growth, and allow the federal banking system to adapt to evolving business needs and customer demands by recognizing the innovative technology-based products and services that are shaping the future of the banking industry.

The OCC has the authority to grant charters for national banks pursuant to the National Bank Act,⁴ which includes the authority to grant charters for "special purpose national banks." Special purpose national banks are not a new phenomenon. Historically, the most common types of special purpose national bank

charters are trust banks (national banks that only engage in trust company activities) and credit cards banks (national banks that only engage in credit card business). 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: receiving deposits, paying checks or lending money. In addition, according to the OCC, the National Bank Act allows the OCC the flexibility to permit banks to engage in new or novel activities as part of the business of banking. Accordingly, the OCC would consider the approval of new activities engaged in by fintech companies seeking to obtain a special purpose national bank charter on a case-by-case basis.

Based on the OCC’s authority to grant charters for special purpose national banks, it is now moving forward with a plan to charter fintech companies that offer at least one of the three core banking functions and otherwise meet the “special purpose” chartering conditions described above. A national bank charter authorizes a bank to conduct business on a nationwide basis and subjects the bank to federal oversight. From the OCC’s perspective, the decision to make available special purpose national bank charters to fintech companies should lead to increased safety and soundness within the financial services industry because, as noted above, fintech companies have been largely unregulated or covered by a patchwork of sometimes contradictory state regulations.

Rules Applicable to a Special Purpose National Bank

Statutes and regulations that, by their terms, apply to national banks also apply to all special purpose national banks — even uninsured national banks. This means that special purpose national banks are subject to most of the same regulation as traditional national banks, depending on the types of banking products and services that the special purpose national banks offer. Such banks are also subject to the Bank Secrecy Act and other anti-money laundering laws. Special purpose banks, like other national banks, are subject to economic sanctions administered by the Office of Foreign Assets Control and certain portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Those special purpose national banks that engage in lending to consumers must comply with all federal consumer lending laws, including the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Fair Housing Act, the Servicemembers Civil Relief Act and the Military Lending Act.

In addition, since all national banks, including those designated as special purpose banks, are generally required to be members of the Federal Reserve System, chartered fintech companies would also be governed by the same rules as other member banks. The OCC has traditionally coordinated with other banking regulators with respect to charter-related activities, and a fintech company’s application for a special purpose national bank charter would receive the same level of coordination between the OCC and any other regulator that also has oversight authority over such company.

Notably, national banks that are insured by the Federal Deposit Insurance Corporation (FDIC) differ from special purpose national banks — many of which do not accept deposits and therefore are not required to maintain FDIC insurance — in that certain statutes and regulatory requirements relate specifically to national banks that are FDIC-insured. This means that special purpose national banks that are uninsured would not be covered by these provisions. One of the most notable statutes that applies only to insured institutions is the Community Reinvestment Act (CRA), which provides a framework relating to the credit needs of the communities in which such institutions operate. However, even though special purpose national banks would be exempt from any requirements promulgated under the CRA, as discussed in greater detail below, the OCC has suggested that it may use its chartering authority to impose some of the requirements set forth in the CRA as conditions to a fintech company receiving a charter.

Baseline Supervisory Expectations

In many ways, the supervisory standards for fintech companies that will be chartered as special purpose national banks are the same as the standards for all national banks. However, there are aspects particular to fintech companies that may require the OCC to alter its traditional approach to chartering in order to account for the unique issues which fintech companies present. While the OCC has identified the below categories as baseline supervisory expectations for any entity seeking a national bank charter, applicants seeking a special purpose charter are strongly encouraged to meet with the OCC, prior to filing an application, to further discuss how these expectations apply to the applicant's proposed bank.

- **Business Plan** – Any company seeking a national bank charter from the OCC must submit a well-developed business plan as part of its charter proposal. The plan must define the market the bank would serve as well as the products and services that it would provide, and the plan must also demonstrate a realistic assessment of risk. The business plan is required to cover a period of at least three years.
- **Governance Structure** – The OCC will require any company seeking a special purpose national bank charter to have the necessary expertise, financial acumen and risk management systems to ensure the safety and soundness of the institution. The Board of Directors must also have an active and independent role in oversight.
- **Capital** – Like any bank, special purpose national banks would be subject to rules designed to maintain minimum capital levels that are appropriate based on the bank's activities. The OCC notes, however, that capital requirements may have to be tailored differently for fintech companies because such companies are more likely to engage in business activities that are off-balance sheet. The traditional capital requirements may not be sufficient because the off-balance sheet risk would not be fully appreciated, and therefore applicants whose business activities may be off-balance sheet would be expected to propose a minimum level of capital that the applicant's proposed bank would meet or exceed at all times.
- **Liquidity** – Liquidity requirements prepare banks to meet expected and unexpected cash flows and collateral needs at reasonable cost and without creating risk for the bank. The OCC will consider both the access to funds and the cost of funding in assessing a proposed bank's liquidity position.
- **Compliance Risk Management** – The OCC would require a fintech applicant for a special purpose national bank charter to have a strong compliance infrastructure like any national bank. For fintech companies, this would include describing its proposed banking activities in sufficient detail so that the OCC can properly understand the applicant's anti-money laundering risk. The OCC would consider how innovative products and services offered by fintech companies would affect their risk profiles.
- **Financial Inclusion** – The OCC's statutory mandate includes ensuring that national banks treat customers fairly and provide fair access to financial services. The White Paper defines financial inclusion to mean that "individuals and businesses have access to useful and affordable financial products and services that meet their needs."⁵ For insured depository institutions, the CRA helps to ensure that banks are reaching out to the financially underserved. As noted above, the CRA would not apply to any fintech special purpose national bank that is not FDIC-insured. However, the OCC has the unique ability to impose requirements through the chartering process to require companies seeking national charters to support financial inclusion in meaningful ways, as appropriate for the business model and activity of a particular company. Accordingly, the OCC would require a fintech applicant for a special purpose national bank charter to explain its commitment to financial inclusion in its business plan in order for approval. The OCC could use its chartering authority to impose requirements (including those similar to the CRA) on fintech applicants in order to promote financial inclusion.
- **Recovery and Exit Strategies; Resolution Planning** – A proposed bank's business plan must include alternative business and recovery strategies to account for specific financial or other risk

triggers that would prompt the determination by the Board of Directors or management to unwind the bank's operations in an organized manner.

Reaction and Impact

Although this OCC announcement is just the first step towards developing and implementing a formal agency policy for evaluating fintech companies' applications for special purpose national bank charters, the move has already created quite a response within the financial services industry. In general, fintech companies appear to be supportive of the announcement, as they have long been lobbying for a chartering process that will give them a viable option to address the challenges they face in dealing with the patchwork of state and federal regulation. However, some companies are apprehensive about how burdensome the new chartering process and inherent regulatory obligations might be for smaller entities — despite assurances from the OCC that it will be flexible in designing requirements for new companies. The OCC notes that a special purpose national bank charter may not be appropriate for all fintech companies and emphasizes that merely making the charter available does not create a requirement to seek one. In fact, a fintech company may choose to operate under a state bank charter or remain outside the banking system if this makes more sense based on the company's business model and customer service strategy.

Banks may also be happy to see a path towards regulation for their unregulated fintech competitors. Banks (especially community banks) and their industry representatives have in the past expressed the view that this regulatory asymmetry creates an unfair advantage that fintech companies have increasingly exploited in recent years. However, while the special purpose charter may mollify many of the banks' concerns in this regard, those that maintain the view that fintech companies must be as stringently regulated as traditional banks in order to ensure fair competition may be concerned that the OCC's proposal may allow for a "lighter touch" regulatory approach for fintech companies. To address such concerns, Comptroller Curry clarified that if the OCC grants a national charter to a fintech company, the institution will be examined regularly and held to the same high standards the OCC has established for all federally chartered institutions.

Perhaps the group most concerned about the OCC's announcement are state banking and financial services regulators. Among other things, state regulators are concerned about how a national charter would pre-empt state laws as they pertain to fintech companies that obtain a special purpose national bank charter. Comptroller Curry tried to assuage these fears in recent remarks, explaining that state law will be pre-empted to the same extent that it is for traditional national banks. This means that state laws regarding anti-discrimination, fair lending, debt collection, criminal laws and torts are still applicable to nationally chartered banks. The types of state laws that generally would be pre-empted and thus not apply to special purpose national banks would include those that impose licensing requirements in order to engage in certain types of business. Additionally, other state laws that only incidentally affect national banks' exercise of their federally authorized banking powers are not preempted. Comptroller Curry also noted that the OCC has taken the position that state laws that target unfair or deceptive treatment of customers are not preempted and thus also apply to national banks. Some state regulators also believe that experimenting with new regulation is more appropriate at the state-level before creating national standards, while others have expressed the view that most fintech companies can be "placed within the context of existing [state] law."⁶ Furthermore, some state regulators have suggested that a federal charter for fintech companies does not seem appropriate given that the historical reasons that have justified the use of federal business charters — including to address a national crisis, stabilize the financial system and produce broad, public benefits — do not apply to the fintech industry.⁷

Conclusion

The OCC's decision to provide fintech companies with the option to become chartered as special purpose national banks has garnered the support of many participants in the financial services industry, while at the same time generating strong opposition from other parts of the industry. The comment period, however, will provide industry participants and other interested parties with the opportunity to provide feedback to the OCC on all aspects of the proposal to make special purpose national bank charters available to fintech companies. In seeking and encouraging stakeholder comments to inform its approach going forward, the OCC is hopeful that such comments will help the agency develop and implement a formal policy for evaluating fintech companies' applications for special purpose national bank charters that will ensure that the OCC's chartering decisions promote the safety and soundness of the federal banking system, increase financial inclusion and protect consumers from abuse.

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Endnotes

¹ Press Release, "OCC to Consider Fintech Charter Application, Seeks Comment" (Dec. 2, 2016); Remarks by Thomas J. Curry, Comptroller of the Currency, Regarding Special Purpose National Bank Charters for Fintech Companies, Georgetown University Law Center (Dec. 2, 2016) [hereinafter *Remarks by Comptroller Curry*].

² OCC, "Exploring Special Purpose National Bank Charters for Fintech Companies" (Dec. 2016) [hereinafter *White Paper*].

³ Remarks by Comptroller Curry at 1, 7.

⁴ 12 U.S.C. 1 *et seq.*

⁵ White Paper at 12.

⁶ Bryan A. Schneider, *The Case Against a Federal Fintech Charter*, American Banker (Oct. 19, 2016), available at <http://www.americanbanker.com/bankthink/the-case-against-a-federal-fintech-charter-1091996-1.html>.

⁷ *Id.*