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When can the OCC charter a fintech as a national bank?

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The Office of the Comptroller of the Currency's plan to create some form of national bank charter for financial technology companies has stirred up a hornets' nest of responses, and the OCC does not seem inclined to let things calm down. Despite opposition from state banking regulators, concerns of some banking industry groups, and several lawsuits, the OCC seems intent on moving forward with its plan. Acting Comptroller Keith Noreika continued, as recently as July 19, to defend the idea of special charters against assertions that they would threaten consumer protection and exceed the OCC's statutory authority.

The dispute over national fintech charters can be analyzed from several points of view. Concerns have been expressed over:

- consumer protection;
- safety and soundness;
- the legality of special purpose national bank fintech charters; and
- the effect of national bank fintech charters on the dual state-federal charter banking system—perhaps, a state v. federal regulators' turf war.

OCC's first steps. The OCC began to move toward granting fintech charters under prior Comptroller Thomas J. Curry, as part of the agency's "responsible innovation framework." Whether national bank charters should be granted to fintech companies conducting banking activities was one of the most important financial innovation questions the agency faced, Curry said (*Banking and Finance Law Daily*, Nov. 4, 2016).

The following month, Curry announced that the OCC intended to create special charters for fintech companies that offer bank products and services. The agency also published "Exploring Special Purpose National Bank Charters for Fintech Companies," which explored related issues (*Banking and Finance Law Daily*, Dec. 2, 2016).

In a Georgetown University Law Center speech, Curry asserted that a special purpose national bank charter would allow the OCC to enhance both consumer protection and safety and soundness. Fintech companies were providing bank-like services without the need to comply with federal laws like the Community Reinvestment Act and without rigorous financial stability standards, he said, and a chartering process would give his agency the ability to introduce more supervision.

At that time, he promised that any fintech companies chartered by the OCC would be held to the same standards that applied to any other OCC-supervised business. Fintech businesses would receive no competitive advantage over traditional national banks that offered the same products and services, Curry pledged.

Licensing manual proposed. In order to create a path toward special purpose national bank charters, the OCC then proposed a dedicated supplement to its *Licensing Manual* (*Banking and Finance Law Daily*, March 15, 2017). The agency again promised that fintech companies receiving national bank charters would be required to meet the same fairness and safety and soundness standards that applied to other national banks. The manual supplement was intended to outline how compliance with those standards would be measured.

The proposed supplement began by describing what fintech companies would be considered to be special purpose national banks that are eligible for charters. A company would have to perform at least one of two bank functions—lending money, or paying checks (or making comparable electronic fund transfers). However, the companies would not be permitted to accept deposits and thus would not be covered by federal deposit insurance. The OCC added that such a company might want to engage in other activities that have not previously been considered to be banking; if so, the company would have to explain why the activity should be considered to be permissible for a chartered institution.

A fintech company that holds a charter would be subject to both leverage and risk-based capital standards, according to the proposed supplement. Since these companies are likely to have comparatively few on-balance sheet assets, higher requirements might be called for. The companies also would be required to comply with the Bank Secrecy Act, related anti-money laundering regulations, and Office of Foreign Assets Control rules.

The OCC sought to assure banks that a special purpose charter will not be an avenue to improperly mixing business and commerce. Products with predatory features, and unfair or deceptive acts or practices, will not be permitted, the agency also said.

Response to OCC plans. Banking industry associations and consumer advocacy groups are, for once, fairly united in their skepticism about the OCC's plans. The American Bankers Association is the most opened minded about the idea of a special purpose charter as long as the fintech companies are held to the same rules and subject to the same oversight as traditional national banks.

However, the Independent Community Bankers of America said a year ago that fintech companies would immediately have a competitive advantage over community banks, especially if the fintech companies were not adequately supervised (*Banking and Finance Law Daily*, June 1, 2016). In April, the ICBA urged the OCC not to act on special purpose charters without clear congressional authorization (*Banking and Finance Law Daily*, April 13, 2017).

Litigation. Of perhaps greater significance is the resistance of the Conference of State Bank Supervisors, which has filed suit in an effort to block the OCC from issuing the planned charters. In is suit, filed in the U.S. District Court of the District of Columbia, CSBS describes the OCC's plan as "an

unprecedented, unlawful expansion of the chartering authority given to it by Congress for national banks." According to CSBS, a bank must, at a minimum, accept deposits; however, the OCC says that fintech companies with special purpose charters will not accept deposits. That means they will not be engaged in the business of banking, CSBS charges, and therefore they cannot be given national bank charters (*Banking and Finance Law Daily*, April 26, 2017).

The complaint in *CSBS v. OCC* raises several specific charges against the OCC. According to the complaint:

- The OCC claims the authority to create charters for a broad variety of nonbank financial services providers, regardless of whether they might be thought of as fintech companies. This exceeds the agency's authority under the National Bank Act.
- The OCC should have proposed a regulation on special purpose fintech charters. Instead, it published a white paper and then proposed changes to the *Licensing Manual*. The agency has never asked for comments on whether the National Bank Act gives it the authority to charter fintech companies.
- The OCC intends, as part of the chartering process, to negotiate a secret agreement with each company about which federal banking laws will be applied to it. Also, by virtue of their federal special purpose charters, the companies will be exempt from state banking laws and regulations, which will create significant preemption issues.

Previous OCC efforts to charter companies that do not take deposits have been rejected by the courts, according to CSBS's complaint. There are only three exceptions—trust banks, banker's banks, and credit card banks. The special purpose fintech companies contemplated by the OCC would not fit into any of those categories, and Congress has rejected efforts to create other special purpose charters, CSBS asserts.

The CSBS suit is not the only court effort to block the OCC. The New York State Department of Financial Services, a CSBS member, has filed a separate suit in the U.S. District Court for the Southern District of New York. In *Vullo v. OCC*, DFS characterizes the OCC's plan as "lawless, ill-conceived, and destabilizing of financial markets that are properly and most effectively regulated by New York State." According to the complaint, "The OCC's reckless folly should be stopped."

In addition to challenging the OCC's authority under the National Bank Act, the DFS alleges that:

- special purpose bank charters for fintech companies would preempt state payday loan, usury, and predatory lending consumer protections;
- multiple non-depository business lines would be consolidated under a single federal charter, resulting in more institutions that are "too big to fail"; and
- a competitive advantage would be given to large, well-capitalized fintech companies that then could overwhelm smaller companies (presumably including community banks, although they were not mentioned specifically).

The DFS also repeats CSBS's claim that judicial precedent has twice rejected OCC efforts to grant charters to companies that do not accept deposits.

OCC response. In remarks prepared for a July 19 appearance at the Exchequer Club, Noreika laid out the OCC's replies to the various objections that have been raised (*Banking and Finance Law Daily*, July 20, 2017). Disclaiming any intent to comment on the two pending suits, Noreika said he could share his views on "the *idea* of granting national bank charters to fintech companies that are engaged in the business of banking and requiring them to meet the high standards for receiving a charter."

Noreika warned against defining the business of banking too narrowly. The banking system must be allowed to evolve and take advantage of technological advances. A national bank charter should be one option for a company that provides banking products and services, while state bank charters, other state financial service provider licenses, and partnerships with existing banks all should be available as well.

One reason for the OCC's plan is the belief that a company which provides banking products and services while acting like a bank should be regulated and supervised like a bank, Noreika said. However, that currently is not the situation, as "Hundreds of fintechs presently compete against banks without the rigorous oversight and requirements facing national banks and federal savings associations." People who fear that national bank charters for fintechs will put banks at a disadvantage "have it backwards," he asserted; banks may be at a disadvantage now, and OCC regulation and supervision could be a remedy.

The OCC has repeatedly pledged that fintech companies given charters would be subject to regular examinations and capital and liquidity standards. They also would be subject to financial inclusion expectations "where appropriate," he said.

Consumer protection concerns are equally misplaced, Noreika claimed. The Dodd-Frank Act clarified the preemption rules, so that state anti-discrimination, fair lending, and other laws apply to national banks. The OCC agrees that many state laws that ban unfair or deceptive acts and practices apply to national banks, he added, and the same ban is imposed by the Federal Trade Commission Act.

Specifically, Noreika attempted to refute claims that charters for fintech companies would "somehow let unfair and deceptive lending practices creep into the federal banking system." He claimed that the OCC has fought against those practices for many years. State-licensed companies, not national banks, are responsible for abuses by payday lenders and similar companies, he charged.

Worries about abuses arising from fintech companies' ability to export interest rates also are "unfounded," according to Noreika. Banks with federal charters have been able to export interest rates for years "without such feared practices taking root," he asserted. Besides, state banks have had the same ability to export interest rates since 1980, he noted.

No deposits. Responding to the litigation claims that the OCC does not have the legal authority to grant national banks charters to companies that do not accept deposits, Noreika made clear the OCC believes it does. A regulation adopted in 2003 made that authority clear he said. (CSBS, in its suit, claims that the OCC can point to no statute that authorized the OCC to adopt that regulation.)

In his speech, Noreika said the OCC had discussed charter applications with fintech companies. The agency intended to continue those discussions, but no applications have been submitted, he told the Exchequer Club. However, less than two weeks later, mobile banking startup Varo Money Inc. applied for a national bank charter for Varo Bank N.A., which would be a full-service bank, not a special purpose bank.

Noreika added that there is no question about the OCC's ability to charter full-service national banks that offer fintech products and services, or about the agency's authority to charter trust banks, banker's banks, and credit card banks. "Many fintech business models may fit well into these long-established categories of special purpose national bank charters that *do not* rely on the contested provision of regulation . . .," Noreika said. The OCC may decide simply to grant charters under that undisputed authority.

The Acting Comptroller did remind the audience that considering special purpose national bank charters for fintechs is an initiative that was started by his predecessor, Comptroller Curry. That makes it a rare example of a financial services initiative begun by the Obama administration and whole-heartedly continued by the Trump administration.

Choice of charters. Noreika made clear his desire to cast special purpose charters as simply one of several options that fintech companies can choose among. In his view, having more options would strengthen the dual-charter system. Granting special purpose charters also would allow the OCC to create a more level playing field between national banks and federal savings associations on the one hand and fintech companies on the other, because all would be subject to the same regulatory standards.

What is a bank? The outcome of the two pending suits likely will turn on the answer to one question: What is a bank? Or, put differently, what is the business of banking? Oddly, federal law offers no succinct definition.

- The National Bank Act—which created the OCC—unhelpfully fails to define either term.
- The Bank Holding Company Act refers in part to the Federal Deposit Insurance Act definition of "insured bank" for its definition, but adds that a bank also can be an institution organized under federal or state law that either accepts demand deposits or offers checking accounts and that makes commercial loans.
- The FDIA says that a bank is a national bank, federal branch, insured branch, or state bank. Interestingly, the FDIA definition of state bank requires the institution to accept deposits, but no comparable definition of national bank is offered.

The NBA describes, in 12 U.S.C. §24, all of the things that a national bank may do. However, it does not describe what a financial institution *must* do in order to be a bank. In 12 CFR §5.20(e), the OCC claims the authority to charter a special purpose bank that engages in at least one of three "core banking functions": accepting deposits, paying checks, or making loans. That regulation is the source of the OCC's assertion that fintechs can be given special purpose charters even if they do not accept deposits.

Precedents. As noted, CSBS and New York's DFS claim that two previous OCC efforts to expand its special purpose charter authority have been rejected. They cite *Independent Bankers Association of America v. Conover*, 1985 U.S. Dist. LEXIS 22529, Fed. Banking L. Rep. ¶86,178, and *National State Bank v. Smith* 1977 U.S. Dist. LEXIS 18184.

Conover offered an in-depth discussion of the issue, reaching the conclusion that a bank must both accept demand deposits and make commercial loans. *Smith*, on the other hand, is a less convincing, not-for-publication opinion that the OCC could not charter a national bank solely as a fiduciary institution with no other banking powers, based on OCC regulations then in effect. As both of these are only district court opinions, they have no binding effect.

***Chevron* effects.** In the end, there is a chance that both suits could be determined by the Supreme Court's far-reaching decision in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842 (1984). Under *Chevron*, a regulatory agency's interpretation of an ambiguous statute is entitled to deference if Congress gave the agency the authority to interpret and implement the statute, the agency's interpretation is reasonable, and the regulation was adopted pursuant to a notice-and-comment process.

The lack of any statutory definition of "bank" in the NBA implies that the word is ambiguous, and the OCC clearly has the authority to interpret and adopt regulations under the NBA. Also, the regulation in question would have been subject to a notice and public comment period.

Therefore, it could be seen as likely that a judge would feel bound to defer to the OCC's conclusion as to what constitutes a bank. In that case, a fintech that carried out any of the three identified core banking functions specified by the OCC regulations could satisfy the criteria to be given a national bank charter.

Premature challenges? Preliminarily, the OCC recently has asked the District of Columbia federal court to dismiss the CSBS suit, claiming the suit is premature. According to the agency, it has not yet decided whether to issue any special purpose national bank charters and the regulation that CSBS is challenging has never been invoked to charter a bank. In fact, Acting Comptroller Noreika's recent statements have made clear that the agency has not yet decided whether or how to proceed. No applications for special purpose charters have been accepted, the motion for dismissal points out.

CSBS cannot describe how the agency's deliberations are causing it any harm, the agency adds.

As a result, there is neither a final action that can be reviewed under the terms of the Administrative Procedure Act nor a case or controversy that gives CSBS constitutional standing to sue, the OCC claims.

The motion also raises the anticipated *Chevron* argument.

