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Analysis of OCC's Fintech Charter Proposal

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On Friday, December 2, 2016, the Office of the Comptroller of the Currency ("OCC") published its long-awaited proposal for how it will address the growing calls for a national financial technology ("Fintech") charter. The paper, "Exploring Special Purpose National Bank Charters for Fintech Companies," (Fintech Proposal"), has been eagerly awaited by online lenders and participants in marketplace lending platforms as a possible to enjoy the same preemption authority of national banks over various state licensing, usury and disclosure requirements. The OCC indicated that it believes its proposal would accommodate fair access to banking products and fair treatment of customers as well as Fintech Companies while preserving the safety and soundness of national banks. Although the Fintech Charter could be used by any entity providing certain financial services, the proposal is of particular interest to consumer and commercial non-depository lenders or providers of technology to aid in the underwriting and origination of such obligations.

Rather than seek new legislation or rulemaking to advance the goal of the Fintech Charter, the OCC proposes to use its existing authority to charter "special purpose national banks." Current OCC regulations allow the OCC to permit "a national bank or a Federal savings association with a special purpose."[1] A "special purpose bank" is one that limits its activities to fiduciary activities or to any other activities within the business of banking. A special purpose bank that conducts activities other than fiduciary activities must conduct at least one of the following three core banking functions: receiving deposits; paying checks; or lending money.[2] A fintech company that currently engages in a bank partnership lending program or another online lending process falls squarely within the purview of the contemplated "special purpose national bank."

The advantage of the national bank charter for a fintech company is that it allows the fintech company to conduct business on a nationwide basis subject to the National Bank Act ("NBA"). The NBA affords national banks broad preemption authority over certain state laws, a key competitive advantage for national banks. The preemption standards applicable to national banks ("Preemption Standard") are found in Dodd-Frank (the "Act").

The Preemption Standard allows national banks to preempt certain state consumer financial laws. State consumer financial laws includes those that directly and specifically regulate the manner, content, or terms and conditions of any consumer financial transaction (as may be authorized for national banks to engage in) or any account related to a consumer financial transaction.[3] The Preemption Standard preempts these state consumer financial laws as they apply to national banks in three circumstances:

- Application of a state consumer financial law has a discriminatory effect on national banks or federal thrifts, in comparison with the effect of the law on a state-chartered bank;

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1 12 C.F.R. § 5.20(c).

2 12 C.F.R. § 5.20(e).

3 12 U.S.C. § 25b(b), (a)(2).

- Federal law other than the National Bank Act preempts the state consumer financial law; or
- In accordance with the legal standard for preemption in the decision of the Supreme Court of the United States in *Barnett Bank of Marion County, N. A. v. Nelson, Florida Insurance Commissioner, et al.*,[4] i.e., the state consumer financial law prevents or significantly interferes with the exercise by the national bank of federal thrifts of its powers.[5]

The third circumstance is of greatest interest to national banks (and the proposed Fintech Charters), as it is the only circumstance where the Comptroller has the ability to make preemption determinations.[6] The Act permits the Comptroller to make a preemption determination under this circumstance only on a case-by-case basis.[7] "Case-by-case basis" means a determination concerning the impact of a particular state consumer financial law on any national bank subject to that law, or the law of any other state with substantively equivalent terms.[8] When making a "case-by-case basis" determination that a state consumer financial law of another state has substantively equivalent terms as one that the Comptroller seeks to preempt, the Comptroller must first consult with the Bureau of Consumer Financial Protection ("CFPB"), the agency created by the Act and tasked with enforcing federal consumer protection laws and regulations.[9] The Comptroller must take the views of the CFPB into account when making the determination.[10] This requirement seems intended to make sure the Comptroller does not overstate the laws that may fall within its preemption determination, requiring consultation with the watchdog of consumer protection to counterbalance any pro-preemption stance the Comptroller may take. However, even if the Comptroller has determined that a state law is preempted, a court may decide that the state law is preempted under the *Barnett Bank* standard. Since the passage of the Act, it has been the courts, and not the Comptroller, that has found several state requirements to be preempted under the Preemption Standard.

The Act has no effect on federal statutes that by their terms apply to national banks. And, these statutes will also apply to Fintech Charters, to the extent applicable. Depending on the type of lending contemplated by a Fintech Charter, it would have to comply with the Truth in Lending Act, Real Estate Settlement Procedures Act, Home Mortgage Disclosure Act, Equal Credit Opportunity Act, Fair Credit Reporting Act, Fair Housing Act, Service Members Civil Relief Act, and Military Lending Act. In addition laws and regulations on legal lending limits and limits on real estate holdings, as well as the Bank Secrecy Act ("BSA"), other anti-money laundering ("AML") laws, and the economic sanctions administered by the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") would apply to a Fintech Charter. In addition, Fintech Charters would generally be subject to the prohibitions on engaging in unfair or deceptive acts or practices under section 5 of the Federal Trade Commission Act and unfair, deceptive, or abusive acts or practices under section 1036 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). In addition, the Preemption Standard will not

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4 116 S. Ct. 1103 (1996).

5 12 U.S.C. § 25b(b).

6 12 U.S.C. § 25b(b)(1)(B).

7 12 U.S.C. § 25b(b)(1)(B).

8 12 U.S.C. § 25b(b)(3)(A).

9 With the election of Donald Trump, who takes office in January 2017, the CFPB's future ability to enforce its obligations under the Act may change, but it is unlikely that its authority will be abolished in full.

10 12 U.S.C. § 25b(b)(3)(B).

protect Fintech Charters from all state laws. Under the OCC's proposal, state law will apply to a Fintech Charters in the same way and to the same extent as it applies to a full-service national bank.

Under the Fintech Proposal, limits on state visitorial authority will also apply in the same way. With regard to visitorial powers, the Act codifies the decision of the Supreme Court of the United States in *Cuomo v. Clearing House Assn., LLC.*[11] In *Cuomo*, the US Supreme Court invalidated a portion of the OCC's rule at 12 C.F.R. § 7.4000 relating to visitorial powers over national banks and their operating subsidiaries. The Court's decision allowed states to retain the right to bring judicial enforcement actions against national banks for violations of non-preempted state laws, including state fair lending laws. Dodd-Frank provides that no provision of Title X of the Act, which applies the preemption standards for national banks, that relate to visitorial powers or otherwise limits or restricts the visitorial authority to which any national bank is subject limits or restricts the authority of any attorney general of any state to bring an action against a national bank in a court of appropriate jurisdiction to enforce an applicable law and to seek relief as authorized by such law.[12] This means that state attorneys general may enforce against national banks any state laws that the Preemption Standard does not preempt.

If the OCC ultimately proceeds with its Fintech Proposal, a special purpose national bank holding a Fintech Charter would look to the relevant statutes (including the preemption provisions added to the National Bank Act by the Act), regulations (including the OCC's preemption regulations), and federal judicial precedent to determine if or how state law applies. For example, under these statutes, rules, and precedents, state laws would not apply if they would require a national bank to be licensed in order to engage in certain types of activity or business. Examples of state laws that would generally apply to national banks include state laws on anti-discrimination, fair lending, debt collection, taxation, zoning, criminal laws, and tort law. In addition, any other state laws that only incidentally affect national banks' exercise of their federally authorized powers to lend, take deposits, and engage in other federally authorized activities are not preempted. Moreover, the OCC has taken the position that state laws aimed at general unfair or deceptive practices apply to national banks. The OCC looks to the substantive content of the state statute and not its title or characterization to determine whether it falls within this category.

The OCC also noted that many laws applicable to FDIC-insured deposition institutions will not apply to a Fintech Charter that does not take deposits, as FDIC insurance is only applicable to banks that take deposits. Certain provisions in the Federal Deposit Insurance Act ("FDIA"), such as section 1831p-1 (safety and soundness standards) and section 1829b (retention of records), only apply to insured depository institutions.[13] In addition, if a national bank is not insured, the provisions in the FDIA governing the receivership of insured depository institutions would not apply. In anticipation of this Fintech Charter proposal, the OCC issued a proposed rule that would address this regulatory gap by establishing a framework for the receivership of an uninsured national bank under the receivership provisions in the National Bank Act.[14] However, the OCC reserves the right to impose requirements on

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11 129 S. Ct. 2710 (2009).

12 12 U.S.C. § 25b(i)(1).

13 Although certain provisions of the FDIA do not apply to uninsured national banks, the OCC can address unsafe or unsound practices, violations of law, unsafe or unsound conditions, or other practices under its other supervisory and enforcement authorities.

14 The proposed rule primarily focuses on uninsured national trust banks, but specifically contemplates application to other special purpose national banks.

an uninsured special purpose bank as a condition for granting a charter that are similar to certain statutory requirements applicable to insured banks, if it deems the conditions appropriate based on the risks and business model of the institution. Fintech Companies considering the Fintech Charter should be mindful that the OCC may require them to comply with the requirements applicable to insured banks. For example, the OCC may require a Fintech Charter to meet requirements similar to those under the Community Reinvestment Act.

Under the Fintech Proposal, the OCC would become the primary prudential regulator and supervisor of Fintech Companies that seek a national bank charter. This does not mean, however, that other regulators cede their oversight authority. Depending on the structure of the bank and the activities it conducts, other regulators will have oversight roles as well. A fintech company considering a special purpose national bank charter likely would need to engage with other regulators in addition to the OCC. Those regulators include:

- *The Federal Reserve*: With rare exceptions, all national banks, including insured and uninsured trust banks and other special purpose national banks, are required to be members of the Federal Reserve System. National banks become member banks by subscribing for the stock of the appropriate Federal Reserve Bank. Since Fintech Charters would be member banks, the statutes and regulations that apply to member banks also would apply to them.

- *Federal Deposit Insurance Corporation*: A fintech company that proposes to accept deposits other than trust funds would be required to apply to, and receive approval from, the FDIC. Generally, a bank must be engaged in the business of receiving deposits other than trust funds for the FDIC to consider granting deposit insurance.

- *Consumer Financial Protection Bureau*: A Fintech Charter that engages in an activity that is regulated under a federal consumer financial law, as defined by Dodd-Frank, may also be subject to oversight by the CFPB. A Fintech Charter that is an insured depository institution generally would be supervised and examined by either the CFPB or the OCC for purposes of all federal consumer financial laws based on its asset size. Only larger Fintech Charters would be directly supervised and examined by the CFPB.

All Fintech Companies seeking a national bank charter would have to undergo an extensive application process and, if approved, would be subject to the OCC's rigorous supervisory standards. A complete discussion of the application process is beyond the scope of this article, but highlights include:

- A *Business Plan* in which the Fintech Company articulates why it seeks a national bank charter and provide significant detail about the proposed bank's activities.
- *Governance Structure* commensurate with the risk and complexity of its proposed products, services, and activities.
- *Capital* commensurate with the risk and complexity of the proposed activities (including on- and off-balance sheet activities).
- *Liquidity* to enable the bank to readily and efficiently meet expected and unexpected cash flows and collateral needs at a reasonable cost, without adversely affecting either daily operations or the financial condition of the bank.
- *Compliance Risk Management* to allow the bank to manage the compliance risks applicable to its activities. For many Fintech Companies engaged in bank partnerships, this will take the form

of a compliance management system as described by the CFPB. Such compliance programs must also ensure and monitor compliance with the requirements imposed by the BSA, other AML statutes, and related regulations, as well as OFAC economic sanctions obligations plus Section 5 of the Federal Trade Commission Act, the unfair, deceptive, or abusive acts or practices prohibitions of Dodd-Frank, and all other applicable consumer financial protection laws and regulations.

- *Financial Inclusion* to demonstrate the commitment of the Fintech Company to low- and moderate-income neighborhoods, individuals, and underserved geographic areas.

More detailed information about the chartering process is in the OCC's Licensing Manual. It is very clear from the Fintech Proposal that the OCC intends to tailor requirements that may apply to a full-service national bank to address the business model of a Fintech Charter.

Whether the Fintech Charter becomes the "go to" method of operating an online lending program remains to be seen. Nevertheless, the OCC's Fintech proposal will potentially provide a path forward for operators seeking certainty with regard to the application of state laws to their current partnership programs.