

The Pros and Cons of the OCC's New FinTech Charter

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► **Special purpose bank charters preempt the patchwork of state laws, but challenges from state bank regulators could cloud the future.**

The Office of the Comptroller of the Currency (OCC) recently announced that it will begin accepting special purpose national bank charter applications from financial technology (aka FinTech) companies. Here, we take a closer look at the pros and cons of the new OCC FinTech charter, including some observations and considerations for alternatives to that charter.

Background

The OCC's decision to begin accepting national bank charter applications from FinTech companies was announced

concurrently with the U.S. Treasury Department's report entitled "Nonbank Financials, Fintech, and Innovation," which included a recommendation that the OCC move forward with "prudent and carefully considered applications for special purpose national bank charters." The special purpose national bank charter for FinTech companies was first proposed by the OCC in December 2016.

The Pros

State Law Preemption

The principal advantage of the OCC FinTech charter is federal preemption of the patchwork of state money transmitter and lender licensing laws. Companies that provide technology-enabled lending services and/or payment and money transmission services should be able to provide

such services under the OCC FinTech charter without having to obtain state licenses to engage in those activities in every state where the services are provided. The OCC FinTech charter would also preempt certain state laws, including, for example, state usury laws, thus allowing interest-rate exportation across all states. The OCC FinTech charter should also preempt state virtual currency activity licensing laws and regulations.

Exemptions From the Securities Laws

Banks are generally exempted from U.S. securities laws. A FinTech company operating under the OCC FinTech charter would be a special purpose national bank and, therefore, should be a "bank" within the meaning of that term under the Securities Act of 1933.¹ Accordingly,

any security issued or guaranteed by such a company would be exempt from the registration requirements of the Securities Act. A FinTech company operating under the OCC FinTech charter should also be a "bank" under the terms of the Securities Exchange Act of 1934, the Investment Advisers Act of 1940, and the Investment Company Act of 1940.² Accordingly, a FinTech company operating under the OCC FinTech charter should be able to rely on the "bank" exemptions under these statutes as well.

Single Regulator

In addition to not having to obtain licenses in a multitude of states, a FinTech company operating under the OCC FinTech charter will have a single regulator and generally will have to ensure compliance with only a single set of regulatory requirements,

as opposed to having to maintain relationships and compliance with multiple regulators.

New Business

Model Feasibility

For some FinTech companies, it may simply not be feasible to operate under a bank license, because banks and all of their affiliates are generally subject to supervision and regulation under the U.S. Bank Holding Company Act (BHC Act). The BHC Act contains certain activity restrictions, with which, as a practical matter, many FinTech companies are unable to comply. The OCC FinTech charter would not trigger issues under the BHC Act, however, because a FinTech company operating under such a charter would not take deposits and would not be deemed to be a “bank” under the terms of the BHC Act.

Also, FinTech companies providing

technology-enabled lending and/or payment services in partnership with banks could potentially re-evaluate their business model and may find that an alternative model based on the OCC FinTech charter is feasible and more profitable. Such model may enable a FinTech company to capture fee revenue that it currently is sharing with a third-party partner bank.

The Cons

Uncertainty

The principal uncertainty surrounding the OCC FinTech charter stems from potential legal challenges to its validity by state banking regulators. The New York State Department of Financial Services (DFS) and the Conference of State Bank Supervisors (CSBS) filed suits challenging the OCC’s FinTech charter soon after it was proposed,

but those suits were dismissed on ripeness grounds. These legal challenges have been renewed now that the OCC has announced that it will accept applications for a FinTech charter.

In addition, it is not yet entirely clear how the OCC would apply a number of the regulatory requirements applicable to national banks to entities operating under an OCC FinTech charter. For example, even though the FinTech licensing supplement discusses capital and liquidity requirements, it is unclear how the OCC’s extensive and complex regulatory capital and liquidity requirements would apply to an entity operating under the OCC FinTech charter. Such uncertainty is certainly a disadvantage of the OCC FinTech charter option.

Onerous Regulatory Requirements

While entities operating under an OCC FinTech

charter will benefit from state law preemptions, they generally will have to comply with the same regulatory requirements that national banks are subject to, which could be substantially more onerous than the requirements applicable to state-licensed money transmitters and lenders. The policy statement and FinTech licensing supplement indicate that a FinTech company operating under the OCC FinTech charter will



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be subject to the same laws, regulations, and high standards of safety, soundness and fairness that apply to all federally chartered banks but note that the OCC will tailor these standards based on the bank's size, complexity and risk profile, consistent with applicable law. The policy statement also says that the OCC will supervise FinTech companies that it charters like similarly situated national banks, including with respect to capital, liquidity, and risk management. As noted above, it is not yet clear how such requirements might be tailored to the operations of a FinTech

company operating under the OCC FinTech charter.

In addition, as noted by the OCC in 2016, 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. Thus, a FinTech company operating under an OCC FinTech charter would likely have to become a Federal Reserve member bank and would be subject to the statutes and regulations that apply to member banks. For example, member banks are subject to certain inter-affiliate

transactions restrictions under Sections 23A and 23B of the Federal Reserve Act.

Limits on Preemption

While an entity operating under an OCC FinTech charter should be able to rely on federal preemption of state money transmitter and lender licensing laws, not all state laws would be preempted. In particular, "state consumer financial laws"³ generally are not preempted by federal law, and any activities subject to such state consumer financial laws would have to be conducted in compliance with such state laws.

Activity Limits

Even though a FinTech company operating under the OCC FinTech charter would not be a full-service national bank, it would still be subject to the same activity limits national banks are subject to. Accordingly, a FinTech company that operates under the OCC FinTech charter would need to ensure that its nonbanking activities comply with the activity restrictions that apply to national banks.

No Deposit Funding

The OCC has indicated that a FinTech company that wishes to take deposits will need to



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apply for a full-service national bank charter. The special purpose OCC FinTech charter would not permit deposit-taking activities, and entities operating under such charter would not be insured by the Federal Deposit Insurance Corporation (FDIC). Insured deposits are a stable low-cost funding source, and the inability to accept insured deposits is a noteworthy disadvantage of the OCC FinTech charter.

Other Observations and Considerations

The OCC FinTech charter seems attractive in light of its state law preemption powers and regulatory feasibility for FinTech companies. Considering the uncertainty surrounding the charter and the onerous regulatory requirements that accompany it, however, it may not be the best option for FinTech companies looking to provide

technology-enabled banking services. FinTech companies with existing licensing arrangements or operating under a bank partnership model may have little incentive to switch to an OCC FinTech charter. The OCC FinTech charter seems more attractive from the perspective of FinTech companies contemplating a new venture for the provision of technology-enabled payments and/or lending. But such new entrants may have difficulty meeting OCC's chartering standards and complying with the relevant ongoing regulatory requirements.

As an alternative to the OCC FinTech charter, FinTech companies seeking to provide technology-enabled banking services could explore the potential viability of an industrial bank charter. Similar to the OCC FinTech charter, an industrial bank charter provides

an exemption from the definition of the term "bank" under the BHC Act, and FinTech companies that acquire an industrial bank charter do not become subject to the activity restrictions of the BHC Act. A state-issued industrial bank charter does not preempt the licensing laws of other states, but the state money transmission laws generally exempt any bank. Accordingly, a state industrial bank charter would address the patchwork of state money transmitter licensing laws that could be triggered by the provision of technology-enabled payment services. Also, a state industrial bank license generally permits interest-rate exportation to other states. ■

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