OCC to Move Forward with Considering Fintech Charter Applications

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Outline

OCC Fintech Charter Announcement and Comments

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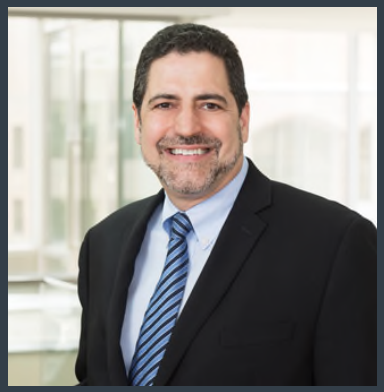
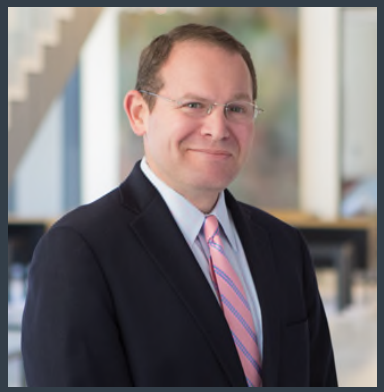


Why Consider a Charter: National Bank Interest Rate Preemption – Madden vs. Midland, True Lender Concerns.

Bob Loeb, Supreme Court and Appellate Litigation



State Regulatory Considerations and Objections

Jeremy Kudon, Public Policy

Potential Challenges to Authority of the OCC to Grant FinTech Charters

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December 2, 2016: OCC Announces Decision to Consider Fintech Charter Applications

- **Policy Reasons**
  - Public interest
  - Economic growth / future of banking
  - Regulatory oversight
- **Certain Requirements**
  - Business plan and operating agreement
  - Corporate and governance structure
  - Capital and liquidity
  - Compliance risk management
  - Financial inclusion (CRA equivalent requirements)
  - Recovery and exit strategies / resolution plan
  - Bank Secrecy Act and anti-money laundering laws
  - Prohibitions on unfair or deceptive acts or practices
- **Practical Considerations**
  - National bank status and attributes
  - Cost savings . . . or . . . regulatory cost burden
  - Comparison to existing regulation
  - Cost of capital, etc.
  - Modified capital and other requirements
  - Competitors
  - Operating considerations
  - Possible failures / consolidations / acquisitions
  - Bank Secrecy Act / AML
  - State laws and regulations
  - Challenges to OCC authority and delay

Comments Requested by OCC on Following Topics

Public policy benefits / risks

Applicable capital and liquidity requirements

Financial inclusion commitment

Protections for individuals / small business borrowers

Business model vs. regulatory expectations

Safety and soundness / public interest

Level playing field

Different approaches for particular products or services

Regulatory coordination

Concentration risk

Comments were due by January 15, 2017

Comment Letters

Fintech Companies	**Generally Support**	• Growth of financial innovations, fintech ecosystem and global finance • Increases financial inclusion and promotes access to banking • Compliance with state regulatory scheme is cumbersome • Consumer and business credit markets should not be partitioned by 50 state borders • OCC should tailor application requirements on case-by-case basis

Comment Letters

Banking Associations

State Regulators and Government Entities

Consumer/Small Business Advocacy Groups and Community Organizations

Generally Oppose or Express Concerns

- OCC should proceed with caution / provide clearer, comprehensive framework
- Statutory authority? Congress's territory
- Lack of consistent regulation / impairs dual banking system
- Fintech reaps benefits of a bank charter without having bank qualities
- Jeopardizes state consumer protection laws / fosters irresponsible lending

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Strong Headwinds Ahead . . .

- The question is no longer WHEN OCC will grant its first charter, it's IF.
- Democrats and Republicans don't agree on much, but both are opposed to OCC's federal fintech charter:
  - Senate Democrats
  - House Republicans
  - Deep Blue States (e.g., New York and California)
  - Blood Red States (e.g., Florida and Iowa)

“The creation of an OCC national charter will stifle rather than encourage innovation; it would be an avenue for large, dominant firms to control the development of technology solutions in the financial services industry, thereby harming existing community banks and small businesses seeking to serve local communities.”

Maria Vullo, Superintendent of New York State DFS

"With state regulators already licensing fintech firms and ably overseeing them, the OCC has offered a solution to a problem that does not exist. Florida's financial services industry has experienced exponential growth under a practical state regulatory system. One size does not fit all. Fintech regulation is best left to the states."

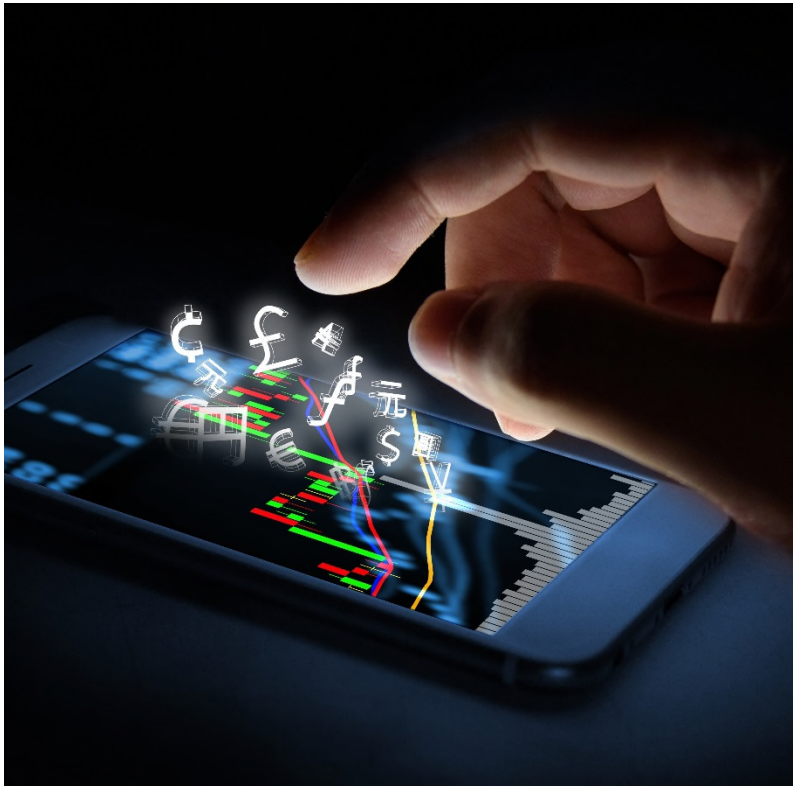
Drew J Breakspear, Commissioner of
Florida's Office of Financial Regulation

So Why Are States Opposed?

- Fintech is not so very different from the banks that states have historically licensed and regulated.
- Federal charter = consumer protection vacuum.
- Preempt state usury laws and allow payday lenders to enter states that have long banned them.
- This will hurt, not help innovation.

So What Have States Done?

- Many commentators thought regulators would respond to OCC's fintech charter announcement with a wave of proscriptive fintech legislation and/or regulations.
- Instead, they have sat on the sidelines. With only a few weeks remaining in most state legislative sessions, only New York has considered fintech legislation.



Crystal Ball Time

So what's next?

- Delay, delay, delay: Lawsuit provides President Trump and Congress with enough time to nominate and confirm a new Comptroller of the Currency and jettison the current iteration of the federal fintech charter.
- More of the same: No one receives a fintech charter and states continue to regulate and/or pass comprehensive fintech legislation.
- The OCC strikes back: OCC shrugs off lawsuit and Congressional opposition and grants charters in June.
- Never going to happen: Congress passes its own special purpose charter for fintech companies.

Why Consider a Charter: National Bank Interest Rate Preemption – Madden vs. Midland, True Lender Concerns

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Interest Rate Portability

- The National Bank Act (12 U.S.C. § 85) and the Depository Institution Deregulation and Monetary Control Act (12 U.S.C. § 1831d) authorize national & state-chartered banks to make loans throughout the country at the "interest rates" permitted in their home states. Conflicting state statutes are preempted.

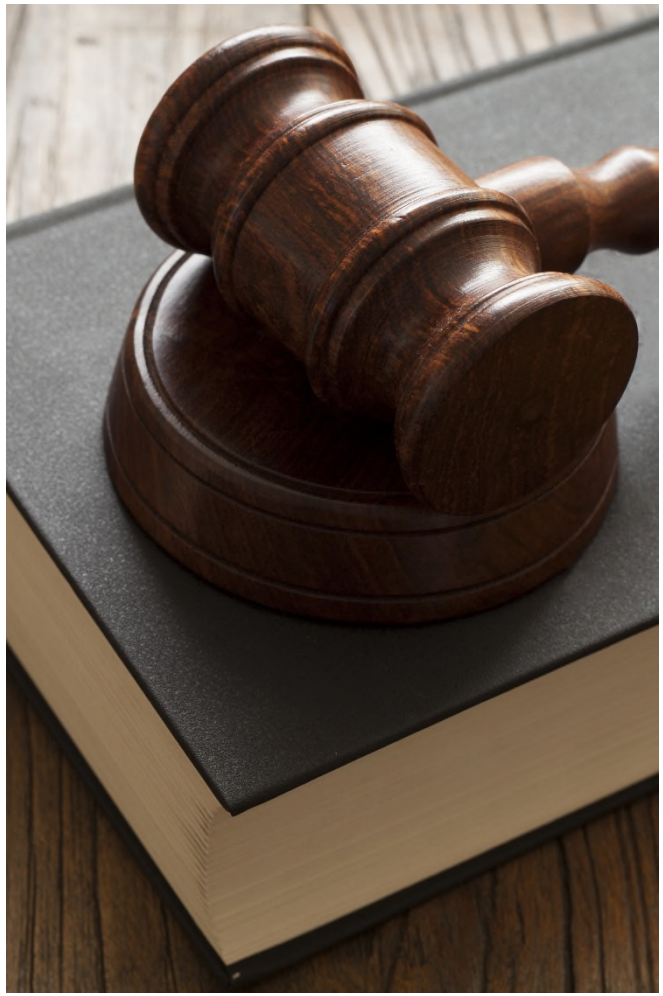
- The "preemptive reach" of §§ 85 and 1831d is not limited "only to a national [or state-chartered] bank itself." Watters v. Wachovia Bank, N.A., 550 U.S. 1, 18 (2007). State law will be preempted in any instance in which it "significantly impair[s]" a bank's exercise of its powers. Id.

Madden v. Midland Funding (2d Cir.)

- Madden, a New York resident, opened a credit card account with the Bank of America (national bank). Bank of America transferred the account to FIA Card Services (affiliated National Bank in Delaware).
- Annual interest rate set in Delaware was 27%, which was permissible under the NBA but which exceeded the general usury rate in New York.
- When Madden failed to make timely payments, FIA charged off the debt and sold the plaintiff's debt to defendant, Midland Funding (third-party debt purchaser that is NOT a national bank).
- Midland sought to collect the debt in NY at the Delaware interest rate.

Madden (cont.)

- Madden brought a class action, alleging violation of NY's usury law.
- District Court holds NY law preempted by NBA
- Second Circuit – No preemption of state usury laws. Preemption does not extend to "third-party debt collectors" – that act neither on behalf of or as an agent of the bank.
  - Here, no retained ownership interest by the bank in the defaulted loans
  - Application of the state law "would not significantly interfere with any national bank's ability to exercise its powers under the NBA."



Supreme Court Denies Review

- Cert. Petition
- Court calls for views of the United States
- US and OCC Brief: Madden is wrong, but no conflict among the circuits
  - The power to issue loans at rate is the power to sell it at that rate. This reflects the long-established "valid when made" principle, which the Supreme Court has called the "cardinal[] rule in the doctrine of usury." Nichols v. Fearson, 32 U.S. (7 Pet.) 103, 109 (1833). Under that principle, a loan that is lawful when it is made cannot later become usurious through assignment. Section 85 (and by extension 1831d) embody the "valid-when-made" principle.
- Court denies review

Distinguishing *Madden*

- *Madden* arose in the defaulted debt context. The sale of defaulted debt is attenuated from the core banking activity of extending credit at an applicable rate and collecting or assigning performing debt. It follows that application of state usury law would work a less significant impairment on the bank's powers.

- *Madden* depended on the complete absence of any retained interest on the part of the national bank. Where a bank retains at least a partial interest in repayment, there is a stronger case for preemption of state law and enforcement of the rate of the issuing bank.

- *Madden* also depended on the complete absence of any ongoing lender-creditor relationship between the bank and the borrower. The existence of an ongoing relationship would strengthen the case for preemption. *Krispin v. May Dept. Stores Co.*, 218 F.3d 919 (8th Cir. 2000).

True Lender Challenges

- Some courts have held that loans sold or assigned to a non-bank are entitled to preemption only if the originating bank is the “true lender.”
- Generally, courts have resolved that issue by asking whether the bank set terms and policies and retained an interest in the loans.
- In the specific context of unscrupulous lenders making high interest loans through sham partnerships with banks, some courts have asked whether the bank retains the “predominant economic interest” in the loans—a more demanding standard.
- If the “predominant economic interest” standard extended to marketplace platforms, it would raise preemption issues.

Colorado Litigation

The Colorado AG has attacked the marketplace platform model based on Madden and True Lender arguments. The Banks are fighting back.

- *Meade v. Marlette Funding*
- *Meade v. Avant*
- *Cross River Bank v. Meade*
- *WebBank v. Meade*

Potential (And Actual) Challenges to Authority of the OCC to Grant FinTech Charters

Chris Cariello, Supreme Court and Appellate Litigation

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Conference of State Bank Supervisors v. OCC (D.D.C.)

Who?	What/How?	When?
- CSBS – "The nationwide organization of state banking regulators" - Competitors? - Individual States?	- Form: Action in district court to enjoin issuance of special purpose charter or charters - Function: Challenge to 12 C.F.R. § 5.20(e)(1)(i) and the Comptroller's two-step	- 1-2 years… - …if nothing pulls the rug out first.

The “business of banking”

- If the Comptroller decides an entity is “lawfully entitled to commence the business of banking” it may issue a charter to conduct such business. 12 U.S.C. § 27(a).
- 12 C.F.R. § 5.20(e)(1)(i): “at least one of … three core banking functions: receiving deposits; paying checks; or lending money”….
- Chevron U.S.A. v. NRDC (1984)
  - Step 0: Would Congress have delegated this issue? Is it one of deep “economic and political significance”? See Cuomo v. Clearing House Ass’n.
  - Step 1: Did Congress define the business of banking? No.
  - Step 2: Is OCC’s interpretation reasonable?

    Statutory text | Statutory framework | Case law | History

No Nonbank Banks and Other Arguments

- Nonbank banks
  - Banks must take deposits.
    - IBAA v. Conover, the BHCA, and historical treatment
    - Getting past ambiguous?
  - When Congress wants special-purpose charters, it says so.
    - National State Bank of Elizabeth and trust banks
    - Credit card banks
- Process/Rulemaking Arguments
- Policy Arguments
  - Interference with State authority, regulatory uncertainty, consumer protection, harm to competition and innovation
  - Will courts care?


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