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Treasury and the OCC Make Significant Fintech Announcements

By Obrea O. Poindexter, Oliver I. Ireland, and Jeremy R. Mandell

Two key federal government announcements were made on July 31, 2018 related to fintech issues. First, the U.S. Department of the Treasury ("Treasury") issued a press release announcing a report entitled "Nonbank Financials, Fintech, and Innovation" (the "Report"). The Report is the fourth and final in a series of reports prepared by Treasury in response to President Trump's February 2017 Executive Order 13772 ("Executive Order"). In addition, the Office of the Comptroller of the Currency (OCC) announced that it would begin accepting applications for special purpose national bank charters from fintech companies that are engaged in the business of banking, but do not take deposits. This alert reviews these important developments.

TREASURY "NONBANK FINANCIALS, FINTECH, AND INNOVATION" REPORT

In response to the Executive Order, and consistent with other reports in the series, the Report identifies laws, treaties, regulations, guidance, reporting, and record-keeping requirements, as well as other government policies that promote or inhibit federal regulation of the U.S. financial system in a manner consistent with certain core principles enumerated in the Executive Order (the "Core Principles").

The Core Principles include: (1) empowering Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth; (2) fostering economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry; (3) enabling American companies to be competitive with foreign firms in domestic and foreign markets; (4) advancing American interests in international financial regulatory negotiations and meetings; and (5) making regulation efficient, effective, and appropriately tailored.

The Report identifies 81 regulatory improvements across a broad range of topics to foster innovation by allowing fintech companies to operate with greater regulatory efficiency. An accompanying fact sheet distills the report's primary recommendations.

Highlights of the Recommendations

Consumer Access to Account Data. Treasury makes several recommendations, including removal of legal and regulatory uncertainties that currently limit financial services companies and data aggregators from establishing data-sharing agreements that would move firms away from screen-scraping to more secure and efficient methods of data access. Treasury recommends a solution developed in conjunction with the private sector that addresses data sharing, standardization, security, and liability issues.

Data Security. Treasury recommends that Congress enact a federal data security and breach notification law to protect consumer financial data and ensure that consumers are notified of breaches in a timely and consistent manner. Treasury recommends that such a law be based on certain principles, including protecting consumer financial data, ensuring technology-neutral and scalable standards based on the size of an entity and type of activity in which the entity engages, recognizing existing federal data security requirements for financial institutions, and employing uniform national standards that preempt state laws.

OCC Special Purpose National Bank Charter. Treasury encourages the OCC to develop a special purpose national bank charter. In so doing, Treasury underscores the importance of the special purpose charter not providing an undue advantage to newly chartered firms, relative to the banks. Shortly after Treasury's release of the Report, the OCC announced that it would begin accepting applications for special purpose national bank charters from fintech companies that are engaged in the business of banking, but do not take deposits.

Third-Party Guidance. In the Report, Treasury recommends that the federal banking regulators coordinate a review of third-party guidance through a notice and comment process, to further harmonize their guidance with a greater emphasis on (1) improving the current tailoring and scope of application of guidance for third-party vendors to improve the efficiency of oversight, and (2) enabling innovations in a safe and prudent manner. The OCC has issued frequently asked questions that address in part the tailoring of the guidance, particularly as it relates to fintech partnerships; however, clarity and consistency should help improve understanding of banking regulators' expectations.

Marketplace Lending. Treasury recommends that Congress codify the "valid when made" doctrine and the role of the bank as the "true lender" of loans it makes. Federal banking regulators should also use their available authorities to address both of these challenges. Action by Congress on these points has the potential to resolve significant industry uncertainty as it relates to loan program partnerships.

Short-Term Small-Dollar Loans. Treasury recommends that the Bureau of Consumer Financial Protection (the "Bureau") rescind its Payday Rule, which applies to nonbank short-term small-dollar lenders. Treasury also recommends that both federal and state banking regulators take steps to encourage prudent and sustainable short-term small-dollar installment lending by banks. The OCC, for example, recently urged national banks to develop such programs.

Debt Collection. Treasury recommends that the Bureau establish minimum effective federal standards for third-party debt collectors, including standards for the information that must be transferred with the debt for purposes of third-party collection or sale. As signaled in its most recent rulemaking agenda, a third-party collections rule is expected from the Bureau early next year.

New Credit Models and Data. Treasury recommends that financial regulators further enable the testing of new credit models and data sources that may support credit underwriting decisions. In particular, regulators should provide regulatory clarity for the use of new data and modeling approaches that are generally recognized as providing predictive value consistent with applicable law for use in credit decisions.

Money Transmitters. Treasury recommends that the states work to harmonize money transmitter requirements for licensing and supervisory examinations, and that the Bureau provide more flexibility regarding the issuance of remittance disclosures. Prior to issuance of the Report, a growing minority of states had initiated a pilot program offering reciprocity for money transmission licenses. Treasury also specifies a timeline for harmonization, stating that "if states are unable to achieve meaningful harmonization across their licensing and supervisory regimes within three years, Congress should act to encourage greater uniformity in rules governing lending and money transmission to be adopted, supervised, and enforced by state regulators."

Federal Reserve Faster Payments. Treasury encourages the Federal Reserve to move quickly in facilitating a faster retail payments system, including by considering development of a real-time settlement service that would allow for more efficient and widespread access to innovative payment capabilities. Treasury also made recommendations related to the Federal Reserve's secure payments task force—including that a solution from the task force, especially as it relates to security, should not include specific tech mandates; however, the Report did not appear to consider the fact that the Federal Reserve announced earlier this year that the secure payments task force would conclude its efforts in March 2018 with a final publication consisting of a collection of educational materials.

Regulatory Sandboxes. Treasury also recommends that federal and state financial regulators establish a unified solution that coordinates and expedites regulatory relief under applicable laws and regulations to permit meaningful experimentation for innovative products, services, and processes. If financial regulators are unable to do so, Treasury recommends that Congress consider legislation to provide for a single process, including preemption of state laws if necessary.

OCC SPECIAL PURPOSE CHARTER ANNOUNCEMENT

As mentioned above, just hours after the release of the Report, Comptroller of the Currency Joseph M. Otting announced that the OCC will begin accepting applications for special purpose national bank charters from fintech companies that are engaged in the business of banking, but do not take deposits. The OCC press release was accompanied by a "Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters" and a Supplement to the Comptroller's Licensing Manual, titled "Considering Charter Applications From Financial Technology Companies."

The OCC says the decision to accept applications follows extensive outreach with stakeholders over two years, and review of public comments on the agency's December 2016 White Paper, "Exploring Special Purpose National Bank Charters for Fintech Companies," and March 2017 Comptroller's Licensing Manual Draft Supplement, "Evaluating Charter Applications From Financial Technology Companies."

According to the OCC Policy Statement, consideration of applications from fintech companies for national bank charters is "one important way that the OCC supports responsible innovation in the federal banking system." In addition, applying the national bank charter framework to fintech companies that qualify "can level the playing field with regulated institutions and help ensure that they operate in a safe and sound manner and fairly serve the needs of consumers, businesses, and communities," as well as "help promote consistency in the application of laws and regulations across the country and ensure that consumers are treated fairly." It is worth noting, however, that the special purpose charter would not be permitted to accept deposits, which means that the bank holding company limitations on permissible activities would not apply to the parent of the special purpose charter (i.e., the fintech company).

The OCC Supplement sets forth key considerations for agency review of the charter application, including evaluation of:

- Whether the applicant's organizers, managers, and directors are well qualified, with diverse experience in relevant areas, and whether they have experience in highly regulated industries, including relevant experience needed to implement the proposed bank's business plan.
- The applicant's business plan, which should describe the bank's proposed activities, define the market that the proposed bank plans to serve and the products and services it will offer, establish the bank's written goals and objectives, explain how the bank will organize its resources to meet its goals and measure its progress, and articulate a clear path and timeline to profitability.
- The business plan's description of the proposed bank's risk management framework to identify, measure, monitor, and control risks and the plan's description of the bank's proposed internal system of controls to monitor and mitigate risk, including management information systems.
- The applicant's risk assessment, which should demonstrate a realistic understanding of risk, describe management's assessment of all risks inherent in the proposed business model and products and services, and set out the degree of risk the bank intends to assume (i.e., its risk appetite) and how it would manage the identified risks.
- The applicant's capital, the minimum and ongoing levels of which should be commensurate with the risk and complexity of the proposed activities, as well its liquidity profile and funds management.
- The applicant's commitment to financial inclusion.
- The applicant's contingency plan, which should address significant financial stress that could threaten the viability of the bank and outline strategies for restoring the bank's financial strength and options for selling, merging, or liquidating the bank in the event the recovery strategies are not effective.

The Policy Statement and the Supplement appear to be attuned to feedback the OCC has received as it relates to ensuring a level playing field between special purpose charters and national banks. As an example, the OCC previously received feedback on ensuring that special purpose charters have comparable obligations with respect to financial inclusion. The Policy Statement and the Supplement both address the special purpose charter's affirmative responsibility to serve their communities.

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We will continue to monitor developments as they relate to Treasury's recommendations in the Report and the OCC's special purpose charter.

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