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Evaluating the OCC's new FinTech Charter

On July 31, 2018, the Office of the Comptroller of the Currency (“OCC”) announced that it would begin accepting applications for national bank charters from FinTech entities that satisfy the licensing requirements for national associations but do not take deposits.¹ The general requirements for special purpose banks other than those engaged in fiduciary activities are set forth in 12 CFR 5.20(e)(1), and include receiving deposits, paying checks, or lending money. Given the exclusion of deposit taking, to obtain a special charter of the type now authorized, a FinTech company must persuade the OCC that it engages in an activity that can be treated as equivalent to paying checks or lending money.

The novelty of this special charter does not, however, obviate the need to consider the OCC’s otherwise standard licensing practices. In its *Policy Statement on Financial Technology Companies’ Eligibility to Apply for National Bank Charters*, the OCC has confirmed that existing chartering standards and procedures will apply to applications by FinTech entities and that the OCC will consider “whether a proposed bank has a reasonable chance of success, will be operated in a safe and sound manner, will provide fair access to financial services, will treat customers fairly, and will comply with applicable laws and regulations.”

FinTech companies contemplating whether to apply for the new charter as a way to scale or operate more efficiently should consider not only the old and the new aspects of the OCC’s licensing procedure but also how this new charter fits into the other regulatory possibilities and constraints that may apply to their activities.

LICENSING ISSUES

Eligibility

The OCC will require a proposed bank to have and continue to have capital and liquidity that are adequate to support its business activities over time; have organizers and management with appropriate skills and experience, including experience in financial services, highly regulated environments and technology; have and maintain effective corporate



governance; have processes or plans for risk management that will effectively identify, measure, monitor and control complicated risks; be committed to financial inclusion; and have an adequate contingency plan to deal with financial stress.

Procedures

The licensing standards and procedures announced by the Comptroller generally follow those applied to traditional national bank charter applications, but modify their substance in several ways and make them somewhat less specific. For example, it is routine to have meetings with the Comptroller's staff to familiarize the applicant with the licensing procedure and allow the staff to learn about the people and business plans they will have to evaluate. In the course of the application process, the qualifications of the organizers and the proposed bank officers, the viability of the business plan and the sufficiency of the proposed capital will always be described and evaluated.

In the case of special licenses for FinTech banks, however, there appears to be somewhat more emphasis on demonstrating the solidity of the proposed business plan, the strength and effectiveness of the procedures that will identify and manage risk and the viability of plans to deal with potential failure. This apparent shift in emphasis may well derive from several factors, including the lack of certainty as to the types of activities for which FinTech banks may ultimately be found eligible and the willingness of the Comptroller to consider granting licenses to businesses that cannot yet demonstrate how they might be affected by economic fluctuations.

Conditions that may be imposed

Although FinTech banks will not be insured by the Federal Deposit Insurance Corporation (FDIC), the Comptroller reserves the right to impose on them conditions that by their terms apply only to insured banks, such as the requirement of financial inclusion.² A FinTech company that receives a special national bank charter must demonstrate a commitment to financial inclusion similar to the Community Reinvestment Act expectation for national banks that take deposits.

The amount of capital that will be required is less certain than usual, presumably both because FinTech banks will not take deposits and will therefore be more dependent than most other banks on other sources of funding and because the capital needs of the various potential kinds of FinTech banks (both in ordinary times and in times of financial crisis) need to be developed and understood pragmatically over time. This could lead to the imposition of capital requirements that ultimately prove to be overly conservative.

Continued separation of banking from commerce

The OCC's draft Licensing Manual Supplement indicated that "Proposals that inappropriately commingle banking and commerce could introduce into the banking system risks associated with non-banking related commercial activities, interfere with the efficient allocation of credit throughout the U.S. economy and foster anti-competitive effects and undesirable concentrations of economic power, and would thus be inconsistent with the OCC's chartering standards. Proposals from companies that implicate such concerns will not be approved." While the OCC did not include this provision in the final version of the Licensing Manual Supplement, the Policy Statement reflects this view in its description of how the OCC will exercise its chartering authority: "Exercising the OCC's existing authority to grant special purpose charters does not alter existing barriers separating banking and commerce." This will put pressure on interpreting the meaning of paying checks and making loans, especially the scope of the term "paying checks," because these are the terms that define the outer limits of the OCC's chartering authority.³



Legal uncertainty

This uncertainty has been at the heart of the debate about the OCC's authority to issue a so-called FinTech charter. State regulators generally, and the New York Department of Financial Services (NYDFS) in particular, oppose the FinTech charter. Asserting that the OCC would exceed its statutory authority if it granted a FinTech charter, both the Conference of State Bank Supervisors (CSBS) and the NYDFS sued the OCC to prevent any such grant. While those suits were dismissed for lack of ripeness, it may be that one or both of these entities will renew their legal challenges now that the OCC has determined to move forward. Presumably, a renewed suit would not be ripe until a FinTech charter has actually been granted; even in that case a suit seems unlikely to be successful unless the business plan of the newly chartered entity seemed well outside the scope of paying checks and making loans. Nevertheless, the potential uncertainty will need to be considered by businesses that are evaluating FinTech charters.

RELATIONSHIP TO OTHER REGULATIONS

Preemption of state law

Some provisions dealing with the powers of national banks preempt conflicting state law,⁴ but others do not.⁵

For FinTech companies engaged in lending money or facilitating payments electronically, the OCC charter may be attractive because the combination of federal preemption and treatment as a bank as opposed to a non-bank may limit or obviate the need to obtain multiple state licenses and otherwise simplify commercial relationships.

Federal preemption of state usury laws has been of great use to specialized banks such as credit card lenders. However, even where operating as a national bank does not have a preemptive effect, being treated as a national bank rather than as a non-bank may reduce state regulation, as in the case of state money-transmission statutes, which by their terms do not impose additional licensing requirements on banks. On the other hand, it is also possible that in particular cases, decisions about the relative administrative burdens of state versus federal regulation, such as the costs of supervision, compliance and capital, may lead a FinTech company to choose state regulation.

Securities laws

Securities issued by FinTech banks will arguably be exempt from the application of the Securities Act of 1933 because they will be securities issued by national banks (although they will presumably have to observe the Comptroller's requirements regarding the issuance of securities). FinTech banks will also literally satisfy the definition of "bank" in the Securities Exchange Act of 1934 and thus potentially be eligible for, among other things, treatment as a bank with regard to various broker-dealer provisions. However, because they will not take deposits and arguably will not engage in trust activities,⁶ FinTech banks will presumably not be treated as banks under the Investment Company Act of 1940 or the Investment Advisers Act of 1940.

Access to the Fed's payment system

The Federal Reserve has yet to indicate whether FinTech banks can become members of its system, and the OCC left the issue unaddressed when it announced that it would begin accepting applications for new charters. For the most part, national banks are required to become members of the Federal Reserve System. However, those banks typically accept deposits and are regulated by the FDIC. That is not the case here, and the uncertainty as to whether a FinTech bank will gain access to the Fed's low-cost payment system may deter some potential applicants, although the overall regulatory benefits of a single regulator may for some outweigh any inability to gain such access.

FDIC insurance and capital structure

While FinTech banks will be limited in the sense that they cannot accept deposits, they will in return not be subject to regulation by the FDIC nor will they pay a deposit insurance premium, a significant cost savings compared to traditional



deposit-taking institutions.⁷ Note, however, that the OCC has stated its intention to impose requirements on FinTech banks that are strictly speaking applicable only to insured depository institutions. In addition, the inability to take deposits may require efforts at raising capital that go beyond those common among ordinary bank start-ups.

Other options

The OCC has emphasized that a FinTech charter “is only one option among many” at both the state and federal level. FinTech companies have the discretion to select other structures such as a state bank charter, an industrial loan company charter or other types of licenses (e.g. money transmission licenses or lender licenses). Alternatively, for those organizations that are not concerned about Bank Holding Company Act compliance and that otherwise could meet full-service national bank standards, that option still exists. However, for some financial technology firms, the new OCC FinTech charter may prove to be the best alternative.

CONCLUSION

In addition to evaluating whether it can satisfy the requirements and operate under the types of conditions imposed by the OCC, a FinTech company will need to compare its ability to operate under such a license with its ability to operate without it. The wording of the Policy Statement and the Supplement to the Licensing Manual, when considered in the light of other potentially relevant federal and state laws and regulations, make this task somewhat more daunting and complicated than usual. Anyone thinking about applying for a FinTech charter should carefully consider the regulatory requirements to operate as such, including those concerning capital and liquidity, financial inclusion and risk management. As always, we would be pleased to discuss any further questions you may have regarding the advantages and disadvantages of the new federal FinTech charter.

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¹ The press release issued on July 31, 2018 on the website of the Office of the Comptroller of the Currency contained links to a Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters (<https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/pub-other-occ-policy-statement-fintech.pdf>) and a Comptroller's Licensing Manual Supplement: Considering Charter Applications From Financial Technology Companies (<https://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-considering-charter-applications-fintech.pdf>).

² Appendix B to the Licensing Manual Supplement contains a general statement of the financial inclusion requirements, including the following: "Consistent with the agency's mission to ensure fair treatment of customers and fair access to financial services, the OCC expects any entity seeking an SPNB charter to demonstrate a commitment to financial inclusion that includes providing or supporting fair access to financial services and fair treatment of customers. The nature of that commitment will depend on the proposed bank's business model, and the types of products, services, or activities it intends to provide."

³ The separation of banking and commerce is reflected more directly in the Bank Holding Company Act, which once restricted the activities of holding companies to those closely related to banking but now, in some cases, admit those that are financial in nature.

⁴ See, e.g., 12 U.S.C. 85 with respect to interest rates.

⁵ See, e.g., 12 U.S.C. 25b regarding certain state consumer financial laws. Activities relating to money transmission may represent an intermediate case, where laws (both state and federal) other than the National Bank Act may treat a business with a national bank charter differently than a non-bank.

⁶ There is a separate special license for national banks that engage solely in trust activities.

⁷ The initial base assessment rates for all insured institutions currently ranges from 3 to 30 basis points.