

Second Circuit Dismisses New York DFS Lawsuit Challenging Special Purpose National Bank Charters

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On June 3, 2021, the United States Court of Appeals for the Second Circuit issued an important decision dismissing a lawsuit by the New York State Department of Financial Services (“DFS”), which was challenging the authority of the federal Office of the Comptroller of the Currency (“OCC”) to grant special purpose national bank (“SPNB”) charters.^[1] Such non-depository charters have attracted the attention of financial technology (“fintech”) companies. The decision reversed a holding of the United States District Court for the Southern District of New York that had placed greater power in state regulators’ hands in holding that the OCC lacked such authority because such non-depository institutions are not engaged in the “business of banking.” The Second Circuit’s decision, which was based on threshold standing and ripeness grounds, maintains ambiguity in the federal-state balance with respect to regulation of SPNBs and threatens to narrow DFS’s regulatory and supervisory reach over cutting-edge financial products and services, which the agency has sought to expand in recent years.

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DFS Challenges Special Purpose National Bank Charters

The lawsuit centered around the National Bank Act of 1864, which provides for OCC regulation and supervision of federally chartered national banks in their “business of banking.” The statute provides that if “it appears that [an entity applying for a federal banking charter] is lawfully entitled to commence *the business of banking*,” the Comptroller shall “give to such association a certificate . . . that such association has complied with all the provisions required to be complied with before commencing *the business of banking*, and that such association is authorized to commence *such business*.”^[2] Once a bank receives a federal charter,

It shall have power . . . [t]o exercise . . . all such incidental powers as shall be necessary to carry on the *business of banking*; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; *by receiving deposits*; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes . . .^[3]

In 2003, the OCC amended federal regulations to provide for authority to issue SPNB charters, or charters for a national bank that engages in a limited range of banking activities, “including one of the core banking functions [*i.e.*, paying checks or lending money], but does not take deposits.”^[4] In amending these regulations, the OCC thus asserted that it had authority to charter entities that pay checks or lend money, among other activities, but that do not receive deposits. These regulations, however, were largely ignored until then-Comptroller of the Currency Thomas Curry announced in late 2016 that the OCC would consider such charters for fintech firms.^[5]

This announcement met vigorous resistance by DFS, New York’s chief financial regulator.

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According to DFS, the decision to issue federal SPNB charters would lead to a preemption of state law for newly chartered entities and would reduce “critical financial protections” provided in New York, weakening the state’s “regulatory controls on usury, payday loans, and other predatory lending practices.”^[6] DFS also claimed it would lose revenue from assessments levied against fintech companies that do not take deposits, because such companies, which are currently governed primarily by state law, could convert to a federal charter.^[7]

In 2017, DFS challenged the OCC’s regulatory regime, but that lawsuit was dismissed for lack of standing and ripeness.^[8] In 2018, the OCC announced that it would accept applications for SPNB charters under the new regulation.^[9] Soon thereafter, the OCC allegedly invited “Fintech startup companies to come to [its] office in New York to discuss . . . the new [SPNB] charter.”^[10] Fintech companies are “non-bank companies that leverage recent technological innovations to provide financial services and/or products to customers in new ways,” such as mobile payment services, distributed ledger technology, marketplace lending, and crowdfunding sites.^[11] DFS responded to the OCC’s efforts by bringing an action against the OCC in the United States District Court for the Southern District of New York, claiming among other things that the OCC exceeded its authority under the National Bank Act by authorizing itself to grant SPNB charters to institutions that do not accept deposits and that the OCC’s regulation is null and void.^[12]

The District Court’s Decision

The District Court set aside the OCC’s decision to accept SPNB charter applications and held that the OCC had exceeded its authority under the National Bank Act. In particular, the District Court found that the term the “business of banking” in the statute unambiguously requires receiving deposits as an aspect of the banking business.^[13] In reaching that conclusion, the District Court looked to the statute’s text, framework, and history, as well as the history of federal banking law, the long history of the OCC not asserting charting power over special purpose institutions, and the “dramatic disruption of federal-state relationships in the banking industry” sought by the OCC on “a question of deep economic and political significance.”^[14]

Following that ruling, the parties submitted proposed judgments setting aside the OCC’s regulation “with respect to all fintech applicants seeking a national bank charter that do not accept deposits,” but the OCC sought a narrower judgment setting aside the regulation only as to fintech companies that “have a nexus to New York State, *i.e.*, applicants that are chartered in New York or that intend to do business in New York (including through the internet) in a manner that would subject them to regulation by DFS.”^[15] The District Court rejected the OCC’s proposal and set aside the regulation regardless of fintech companies’ location nationwide.^[16]

The Second Circuit’s Ruling

Last week, the Second Circuit reversed the district court’s judgment and instructed the court to dismiss the case without prejudice. The Court concluded that DFS’s claims were unripe and without standing because DFS failed to allege that the OCC’s decision caused it to suffer an actual or imminent injury.^[17] Having determined that the case was not justiciable, the Court did not address the District Court’s holding on the merits that the “business of banking” under the federal banking statute unambiguously requires receipt of deposits.^[18]

The Court concluded that DFS lacked standing because its concerns about the effects of preemption were “too speculative,” given that the OCC’s actions would not implicate such concerns until the OCC received an SPNB charter application from or granted such a charter to a non-depository fintech that would otherwise be subject to DFS’s jurisdiction.^[19] As the Court explained, there is “currently no non-depository fintech that can claim federal preemption engaging in any practice that may give rise to the regulatory harms that DFS alleges, such as charging interest rates that exceed New

York's statutory cap."^[20] The Court was likewise unpersuaded that DFS faced a "substantial risk" of losing revenue acquired through annual assessments under New York law.^[21] The Court explained that DFS has "yet to lose out on any revenue acquired through its assessments . . . because the OCC has not received, let alone approved, an application for an SPNB charter from a non-depository fintech within DFS's jurisdiction."^[22] The Court declined to "decide the precise point at which DFS's claims may become justiciable in the future," whether it be when a non-depository fintech formally applies for an SPNB charter, when the OCC grants such an application, or some other time.^[23]

Conclusion

This decision represents a setback for DFS and other state regulators who may perceive the OCC's assertion of authority over non-depository institutions as an incursion into an area that has traditionally fallen within the states' ambit. Indeed, as New York's primary financial regulator, DFS has jurisdiction over approximately 1,500 financial institutions and 1,800 insurance companies, and it supervises approximately \$7 trillion in assets across the insurance, banking, and financial services industries.^[24]

The OCC's ability to press forward with fintech companies is of special concern to DFS, which has been actively flexing authority in recent years with respect to contemporary trends in financial services, implementing new initiatives designed to foster innovation in a wide range of services and products, such as cryptocurrencies, while also focusing on consumer protection and bringing fintechs within an expanded regulatory scheme.^[25] The future of regulation over these cutting-edge industries, many of which have close connections to New York, could be impacted by the Second Circuit's ruling.

The effects of the decision, however, should not be overstated. The Court of Appeals made clear that it expressed no opinion on the ultimate issue of whether the OCC has authority to grant national bank charters to non-depository institutions, and it likewise expressed no view on whether the OCC's amended regulation (if unlawful) must be set aside only as to companies applying within a particular jurisdiction such as New York or more broadly nationwide. These important issues are likely to be resolved through future litigation, and indeed, a similar case is pending in the United States District Court for the District of Columbia.^[26] In addition, the new Acting Comptroller of the Currency, Michael Hsu, a longtime member of the supervisory staff of the Federal Reserve Board, has indicated that he intends to take a close look at whether to continue some of the OCC's initiatives launched under the Trump Administration.^[27]

[1] See *Lacewell v. Office of Comptroller of Currency*, --- F.3d ---, 2021 WL 2232109 (2d Cir. June 3, 2021).

[2] 12 U.S.C. § 27(a) (emphasis added).

[3] *Id.* § 24 (Seventh) (emphasis added).

[4] *Lacewell*, 2021 WL 2232109, at *2 (quoting 12 C.F.R. § 5.20(e)(1)(i)); see *Vullo v. Office of Comptroller of Currency*, 378 F. Supp. 3d 271, 279 (S.D.N.Y. 2019), *rev'd*, *Lacewell*, 2021 WL 2232109.

[5] See "Remarks By Thomas J. Curry Comptroller of the Currency Regarding Special Purpose National Bank Charters for Fintech Companies," Georgetown University Law Center (December 2, 2016), available at <https://www.occ.gov/news-issuances/speeches/2016/pub-speech-2016-152.pdf>.

[6] *Lacewell*, 2021 WL 2232109, at *8; see *Vullo*, 378 F. Supp. 3d at 286.

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[7] *Lacewell*, 2021 WL 2232109, at *8, *11; see *Vullo*, 378 F. Supp. 3d at 286.

[8] *Vullo*, 378 F. Supp. 3d at 280.

[9] *Id.* at 279.

[10] *Lacewell*, 2021 WL 2232109, at *4.

[11] *Vullo*, 378 F. Supp. 3d at 378 n.2; see *Lacewell*, 2021 WL 2232109, at *3.

[12] *Vullo*, 378 F. Supp. 3d at 278, 280.

[13] *Id.* at 292.

[14] *Id.* at 292-98 (emphasis added).

[15] *Lacewell*, 2019 WL 6334895, at *1 (S.D.N.Y. Oct. 21, 2019), *rev'd*, *Lacewell*, 2021 WL 2232109.

[16] *Id.* at *2.

[17] *Id.* at *7-13.

[18] *Id.* at *13.

[19] *Id.* at *8-11.

[20] *Id.* at *9.

[21] *Id.* at *11-12.

[22] *Id.* at *12.

[23] *Id.* at *6 n.11.

[24] See N.Y. Dep't of Fin. Servs., *About Us*, https://www.dfs.ny.gov/our_mission; *Vullo*, 378 F. Supp. 3d at 278.

[25] See, e.g., Mylan L. Denerstein, Akiva Shapiro & Seth M. Rokosky, *New York State Dep't of Fin. Servs. Roundup* (2021), <https://www.gibsondunn.com/wp-content/uploads/2021/02/NY-Department-of-Financial-Services-Round-Up-February-2021.pdf>; Denerstein, Shapiro & Rokosky, *Webcast: Recent Developments at the New York State Dep't of Fin. Servs.* (2020), <https://www.gibsondunn.com/webcast-recent-developments-at-the-new-york-state-department-of-financial-services/>; Denerstein, Shapiro & Rokosky, *New York State Dep't of Fin. Servs. Roundup* (2020), <https://www.gibsondunn.com/wp-content/uploads/2020/02/NY-Department-of-Financial-Services-Round-Up-February-2020.pdf>.

[26] See, e.g., Press Release, "Conference of State Banking Supervisors Files New Complaint Against OCC," December 22, 2020, *available at* <https://www.csbs.org/newsroom/csbs-files-new-complaint-against-occ>.

[27] See, e.g., *Statement of Michael J. Hsu, Acting Comptroller of the Currency, Committee on Financial Services, United States House of Representatives, May 19, 2021 (Hsu Statement)*.

Gibson, Dunn & Crutcher's lawyers are available to assist with any questions you may have regarding these issues. For further information, please contact the Gibson Dunn lawyer with whom you usually work, or the authors:

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