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THE U.S. OFFICE OF THE COMPTROLLER OF THE CURRENCY WILL PERMIT SPECIAL PURPOSE NATIONAL BANK CHARTERS FOR FINTECH FIRMS

To Our Clients and Friends:

Last week, the Office of the Comptroller of the Currency (OCC) announced that it would begin accepting proposals from Fintech firms to charter special purpose national banks (SPNBs). This decision comes over 18 months after the White Paper proposing such charters was issued under President Obama's Comptroller, Thomas Curry, in his last month in that position. The OCC accompanied this announcement with a policy statement (Policy Statement) and a supplement to its licensing manual for national banks (Licensing Manual Supplement).

This announcement, while expected, is an extremely significant development in federal banking law, and one almost assuredly to be legally challenged, at a time when the *Chevron* doctrine of administrative agency deference is receiving a fresh look.

The OCC's decision, when considered with its historical approach to preemption under the National Bank Act, could expand the scope of federal banking regulation considerably and provide substantial opportunities. These opportunities could benefit not merely Fintech firms but investors in many such firms, who would appear to be able to control certain SPNBs and still avoid regulation under the Bank Holding Company Act (BHC Act), including the Volcker Rule.

Powers of a Fintech SPNB

When former Comptroller Curry introduced his Fintech national bank proposal in December 2016, he noted that "the number of Fintech companies in the United States and United Kingdom has ballooned to more than 4,000, and in just five years investment in this sector has grown from \$1.8 billion to \$24 billion worldwide."^[1] The Policy Statement – consistent with the OCC's traditional approach to the "business of banking" under the National Bank Act – makes clear that the special purpose charter is a response to this development, noting:

The OCC recognizes that the business of banking evolves over time, as do the institutions that provide banking services. As the banking industry changes, companies that engage in the business of banking in new and innovative ways should have the same opportunity to obtain a national bank charter as companies that provide banking services through more traditional means.^[2]

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Consistent with its existing regulations, the Policy Statement takes an expansive view of the National Bank Act's powers provision, 12 U.S.C. § 24(SEVENTH). Under this provision, a national bank is permitted, when a charter is issued, to:

[E]xercise by its board of directors or duly authorized officers or agents, subject to law, 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]

Prior to issuing the Policy Statement, the OCC had interpreted this provision to permit it to grant a charter to an institution that engaged in "any of the three core banking functions of receiving deposits, paying checks, or lending money." [4] Consistent with this existing regulation, a Fintech firm seeking a SPNB charter must conduct "at least one of these three core banking functions." [5] The Licensing Manual Supplement, however, provides greater elasticity to this requirement, as it states that "[t]he OCC views the National Bank Act as sufficiently adaptable to permit national banks to engage in traditional activities like paying checks and lending money in new ways. For example, facilitating payments electronically may be considered the modern equivalent of paying checks." [6]

Depending on the OCC's ultimate position on "modern equivalence," a Fintech SPNB charter could be available not only to Fintech firms engaged in lending activities without taking deposits (such as peer-to-peer lending companies), but also to companies engaged in payments broadly understood – including traditional money transmitters, and, in addition, virtual currency exchanges, because such exchanges also engage in money transmission, and indeed many have been licensed by the states as such. It is noteworthy that the Licensing Manual Supplement states that:

Beyond those core activities [deposits, lending, paying checks], the activities of an SPNB are limited to those that are permissible for national banks under a statute, regulation, or federal judicial precedent, or that the OCC has determined to be permissible. See e.g. 12 USC 24(Seventh); 12 CFR 7.5002; *NationsBank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995). [7]

In the *NationsBank* case cited, the Supreme Court, per Justice Ginsburg, "expressly h[e]ld" that "the 'business of banking' is not limited to the enumerated powers in § 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated." [8]

OCC Expectations

As it indicated in its 2016 White Paper, the OCC is not proposing a "bank-lite" approach to Fintech SPNBs.

The OCC expects any charter proposal to have a comprehensive business plan covering at a minimum three years. The plan should include comprehensive alternative business strategies to address various best-case and worst-case scenarios. In keeping with its post-Financial Crisis approach to corporate governance, the OCC emphasized the role of an SPNB's board of directors, who must have a prominent

role in the overall governance framework, actively oversee management, provide "credible challenge," and exercise independent judgment.[9]

The OCC also emphasized the importance of capital, minimum and ongoing levels of which need to be commensurate with the risk and complexity of the proposed activities (including on- and off-balance sheet activities).[10] Where a SPNB's business activities are principally off-balance sheet, traditional minimum capital requirements may not adequately reflect all risks, and the OCC could therefore require applicants in such circumstances to propose a minimum level of capital that the proposed SPNB would meet or exceed at all times. In this regard, the OCC noted that other types of limited charter banks often hold capital that "exceeds the capital requirements for other types of banks." [11] The OCC would expect a similarly granular presentation with respect to a SPNB's liquidity, including consideration of planned and unplanned balance sheet changes, varying interest ratio scenarios, and market conditions.

Charter applicants would also be expected to demonstrate appropriate systems and programs to identify, assess, manage and monitor risk, including policies and procedures, practices, training, internal control and audit. Of particular importance is a compliance program for anti-money laundering and OFAC sanctions, as well as a consumer compliance program designed to ensure fair treatment of customers.

Two very important criteria for receiving an SPNB charter are financial inclusion and contingency planning. As to the first, the OCC states:

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.

An SPNB applicant should describe the proposed bank's commitment to financial inclusion in its application. The description should include the proposed goals, approaches, activities, milestones, commitment measures, and metrics for serving the anticipated market and community consistent with the bank's activities, business model, and product and service offerings.[12]

On the second, because many SPNBs are likely not to be FDIC-insured, the OCC will be such institutions' receiver in insolvency. As a result, the OCC will insist on a detailed contingency plan to be prepared:

Before receiving final approval for a charter, an SPNB will be required to develop a contingency plan to address significant financial stress that could threaten the viability of the bank. The contingency plan should 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 format and content of the plan are flexible and should be tailored to the bank's specific business and reviewed and updated as the bank's business evolves.

As a condition for preliminary approval of a charter, an SPNB will be required to develop the contingency plan during the bank's organization phase. The OCC's final approval will require the bank

to implement and adhere to the plan. The bank will be expected to review the contingency plan annually and update it as needed. Any significant changes to the contingency plan will require the non-objection of the appropriate supervisory office.[13]

As a national banking association, a Fintech SPNB would be subject to the federal statutes applicable to other national banks, such as lending limits, limits on real estate and securities investments, the Bank Secrecy Act and other anti-money laundering laws, OFAC sanctions requirements, and, where applicable, such as with respect to lending, federal consumer law. A Fintech SPNB would be required to become a member bank in the Federal Reserve System and subscribe for stock in its applicable Federal Reserve Bank in an amount equal to six percent of the bank's paid-up capital and surplus.

Benefits of a Special Purpose Charter to Fintech Firms

The principal benefits of the special purpose charter to Fintech firms are national licensing and federal preemption. Currently, peer-to-peer lending firms, money transmission companies, and virtual currency exchanges are all licensed by the states. For such firms to carry out a national business, licensing on a state-by-state basis, and ongoing state examination processes, can be burdensome. The SPNB charter will provide a federal alternative – and one regulator – to the state-by-state approach for qualifying firms.

Second, an SPNB will benefit from federal preemption under the National Bank Act. Such federal preemption is still broad, notwithstanding the Dodd-Frank Act's attempt to narrow it. After the Dodd-Frank Act, the OCC may preempt "state financial consumer law" if

- its application would have a discriminatory effect on national banks in comparison with its effect on state-chartered banks;
- the state consumer financial law prevents or significantly interferes with the execution by a national bank of its powers (the Barnett standard); or
- the state law is preempted by a federal consumer financial law other than Dodd-Frank.[14]

Significantly, Dodd-Frank left unchanged the ability of a national bank to export interest rates of its home state nationally without regard to state law usury limitations; such interest rate exportation will be a significant benefit to SPNBs engaged in lending activities.

Benefits of a Special Purpose Charter to Fintech Investors

The SPNB charter may also provide benefits to Fintech investors, who would appear to be able to make controlling investments in certain SPNBs without becoming subject to the BHC Act, including the Volcker Rule. The BHC Act defines a "bank" as either an FDIC-insured bank or as an institution that both accepts demand deposits and is engaged in the business of making commercial loans.[15] Under the Policy Statement, the OCC can charter a SPNB that does not accept deposit funding – that is, one that is engaged in making loans or paying checks, or both such activities, as its core banking functions; such a SPNB would not be a BHC Act "bank." As a result, such an SPNB may be "controlled" by an investor without that investor becoming a bank holding company.

This means that there is now another alternative to the state industrial bank charter available for investors such as private equity firms that wish to obtain the benefits of controlling a banking entity without the burdens of regulation by the Board of Governors of the Federal Reserve System. In addition, although the OCC can be expected to require some form of capital support from a controlling investor of a non-deposit-taking SPNB, the explicit "source of strength" requirement added by the Dodd-Frank Act for a controlling investor will not apply, because that requirement applies only to controlling shareholders of insured depository institutions.^[16]

As a result, a Fintech firm that seeks a non-depository SPNB charter may find itself attractive to a wide range of investors.

It seems highly likely that certain state regulators will challenge the OCC's Fintech SPNB determination, given its potential to shift a wide variety of firms to federal supervision and examination and preempt areas of state regulation. Earlier such suits filed after the OCC's December 2016 White Paper were dismissed as unripe; however, once the chartering process begins, litigation by state regulators could well be expected. If the OCC's interpretation of the National Bank Act is upheld by a reviewing court, the Fintech SPNB charter could be the most revolutionary development of regulatory reform in the Trump era, for both Fintech firms and their investors.

[1] OCC, Exploring Special Purpose National Bank Charters for Fintech Companies (December 2016), at 3-4.

[2] OCC, Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters (July 31, 2018), at 1.

[3] 12 U.S.C. § 24(SEVENTH).

[4] 12 C.F.R. § 5.20.

[5] OCC, Policy Statement, at 2.

[6] OCC, Licensing Manual Supplement: Considering Charter Applications from Financial Technology Companies, at 2 n.5.

[7] *Id.* at n.4.

[8] 513 U.S. 251, 258 n.2 (1995). Given the *Valic* holding, the OCC would appear to have substantial discretion regarding permissible activities for SPNBs, as long as one core banking function was present. The degree to which the OCC will exercise such discretion is currently unknown.

[9] OCC Licensing Manual Supplement, at 16.

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- [10] *Id.* at 8.
- [11] *Id.* at 9, n.26.
- [12] *Id.* at 10.
- [13] *Id.*
- [14] 12 U.S.C. § 25b(b)(1).
- [15] *Id.* § 1841(c)(1).
- [16] *Id.* § 1831o-1.



The following Gibson Dunn lawyers assisted in preparing this client update: Arthur Long, Jeffrey Steiner and James Springer.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact any member of the Gibson Dunn team, the Gibson Dunn lawyer with whom you usually work in the firm's Financial Institutions practice group, or any of the following:

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