A Turning Point for FinTech? OCC and Treasury Signal Commitment to Financial Innovation

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On July 31, 2018 the Office of the Comptroller of the Currency ("OCC") announced it will begin accepting applications from non-depository FinTech companies for a special purpose national bank charter.[1] This announcement caps a years-long and much anticipated initiative by the agency to make federal banking charters available to FinTech firms (see our prior analysis, here and here describing previous developments).

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The OCC's action came on the same day that the Treasury Department released the fourth report (the "Report") mandated by Executive Order 13772, setting forth the Trump administration's "core principles" for regulating the U.S. financial system.[2] The Report outlines recommendations to foster a regulatory environment that better supports financial technology and innovation among FinTech companies, banks and other financial institutions.

Below we discuss these developments and the issues FinTech companies should consider before pursuing a special purpose OCC charter.

THE OCC FINTECH CHARTER

According to the OCC, the Charter is designed to enable FinTech companies "that provide banking services in innovative ways [,] the opportunity to pursue [their] business on a national scale as a federally chartered, regulated bank." An eligible applicant "engages in a limited range of banking or fiduciary activities, targets a limited customer base, incorporates nontraditional elements, or has a narrowly targeted business plan," and does not plan to take deposits or otherwise be insured by the Federal Deposit Insurance Corporation.[3] Thus, the Charter would allow FinTech companies to become national banks without any parent company becoming a bank holding company

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1 OCC, OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies (July 31, 2018), available here.

2 U.S. Department of the Treasury, Press Release: Treasury Releases Report on Nonbank Financials, FinTech, and Innovation (July 31, 2018), available here.

3 OCC, *Comptroller's Licensing Manual Supplement* (July 2018), available here.

("BHC"), subject to the activity restrictions, capital requirements and other supervisory consequences that flow from BHC status.

While the Charter offers a number of benefits, including the preemption of certain state laws, a FinTech company should carefully consider the associated obligations when evaluating whether to pursue an OCC application:[4]

- Once Chartered, the FinTech company would be subject to the OCC's supervisory and enforcement authority – as though it were a *de novo* bank. While the OCC has said that these requirements will be tailored, the company will be obligated to meet appropriate capital, liquidity and financial commitment obligations. And where a chartered FinTech company fails to meet such obligations, the OCC will have the full range of enforcement tools available to take action, including imposing penalties and activity restrictions.

- The Chartered company also will be required to take steps to address financial inclusion, both as a part of its application and as a special purpose national bank, similar to the obligations of other national banks under the Community Reinvestment Act. In its July 31st announcement, however, the OCC did not detail the scope of such obligations as they might be applied to a FinTech company.

At a minimum, the OCC's announcement opens a new regulatory regime that FinTech companies should consider in their business and strategic planning. For those companies that decide a Charter may be beneficial, the first step is to engage in pre-application discussions with the OCC to explore the viability of a Charter and to understand the nature of obligations that may be imposed on the company.

Alternatively, a charter type that could be considered is an Industrial Loan Company ("ILC") charter. Square has applied for such a charter (which is a state bank that can take deposits) and the new FDIC Chair, Jelena McWilliams, expressed a greater willingness to provide FDIC insurance to such banks during her Senate confirmation hearing.

TREASURY FINTECH REPORT

Reflecting the Trump administration's general skepticism towards the post-crisis regulatory framework, the Report contends that "far-reaching laws that mandated the adoption of hundreds of new regulations" coupled with "the rapid development of

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

financial technologies" drove financial activity out of the regulated banking sector and created opportunities for nonbank financial companies to service market demand. This, according to Treasury, resulted in innovation outside of the regulated institutions that has expanded access and lowered barriers to financial services for previously-underserved individuals and businesses.

To restructure the regulatory environment in ways that will further accelerate this growth and technological innovation, the Report recommends:

Modernizing the Regulatory Framework and Streamlining Fragmented Regimes

The Report calls for greater harmonization of state licensing laws and greater cooperation among state and federal agencies in discharging their supervisory authority. To that end, it calls for the establishment of a FinTech Industry Advisory Panel and, notably, recommends piloting "innovation facilitators," including "regulatory sandboxes" – as testing grounds for innovation.

Regulatory sandboxes have been employed in other jurisdictions (most notably the UK) for some time. Here, regulators allow early-stage companies to launch limited operations without becoming subject to the range of legal obligations that would apply to a fully-licensed entity. The regulator oversees the company's activity and provides periodic feedback throughout the process enabling the company to evaluate whether its business is viable and giving the regulator insight into how its supervisory framework might apply to non-traditional firms.

Although these sandbox arrangements are not without critics, including New York's Superintendent of Financial Services, the Report suggests that the concept has strong support within the Trump administration.[5] In fact, on August 7 the Bureau of Consumer Financial Protection announced its own regulatory sandbox initiative, called the Global Financial Innovation Network, to facilitate increased engagement among regulators with FinTech companies, in order to further financial innovation efforts.[6]

Updating Specific Regulations

Treasury also recommends changes to existing law and regulation to encourage continued financial innovation, including:

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[5] Maria T. Vullo, Statement on Treasury's Endorsement of Regulatory Sandboxes for FinTech Companies and the OCC's Decision to Accept FinTech Charter Applications, New York State, Department of Financial Services (July 31, 2018), available here.

[6] *BCFP Collaborates With Regulators Around The World To Create Global Financial Innovation Network* (Aug. 7, 2018), available here.

- **Marketplace Lending**: The Report recommends that Congress take steps to implement the so-called "*Madden* fix"—*i.e.*, codifying the "valid when made" doctrine and the role of a bank as a "true lender" of loans that it originates, even if the loans are sold to downstream investors that are not banks. Recent case law has called into question the viability of these longstanding principles as to preemption.

- **The Definition of "Control"**: Lack of clarity regarding the Federal Reserve Board's ("FRB") definition of "control" for purposes of the BHC Act may, in Treasury's view, discourage BHCs from investing in FinTech companies. Accordingly, the Report includes a recommendation for the FRB to provide a "simpler and more transparent standard to facilitate innovation-related investments."[7] This is consistent with recent public statements by the FRB's Vice Chairman for Supervision, Randal Quarles,[8] among others. The Report also recommends that the FRB take steps to harmonize the definitions of BHC permissible activities. While the Report certainly could drive the FRB to make such changes, Treasury also could take a more active step in facilitating this harmonization by formally making recommendations to the FRB to modify the list of those activities that are "financial in nature."[9]

- **Third-Party Oversight**: The increased reliance by banks on vendors and third parties and the attendant regulatory focus on these relationships has resulted in rapidly growing compliance costs. The Report recommends that clearer standards be developed and that the regulators take steps to ensure that examiners' application of interagency guidance be more consistent.

- **Credit Modeling and Data**: Because ambiguity exists regarding supervisory expectations for the use of certain data and modeling approaches that are considered to have good predictive value in making credit decisions, the Report calls on regulators to provide consistent standards in evaluating and implementing these models.

- **Payments**: Harmonization of money transmitter requirements and greater flexibility with respect to issuance of remittance disclosures would bring clarity to the payments industry that, in Treasury's view, is lacking under the current framework.

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7 U.S. Department of the Treasury, *A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation* (July 2018), available here.

8 *See* Randal K. Quarles, Vice Chairman for Supervision, Speech on Early Observations on Improving the Effectiveness of Post-Crisis Regulation (Jan. 19, 2018), available here.

9 12 U.S.C. § 1843(k)(2)(B); *see also* Executive Order and DOL Memo Signal Shift in Federal Financial Regulatory Agenda, available here; FinReg Reform Steps Continue: Treasury Report and Choice 2.0, available here.

We hope these perspectives are helpful. Please do not hesitate to contact us with any questions.

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