

# Client Alert

December 2016

## The OCC Moves Forward with a FinTech Charter

The Office of the Comptroller of the Currency (“OCC”) released a white paper on December 2, 2016 elaborating on the OCC’s plan, long in the works, for providing special purpose national bank charters for Financial Technology (“FinTech”) companies.<sup>1</sup> FinTech has long been a priority for the current Comptroller, Thomas J. Curry, and this white paper is a substantial step forward in the process of providing FinTech companies with the option of pursuing a federal banking charter. Such charters could be a viable option for many different types of FinTech companies, particularly for marketplace lenders and payment processors.

The proposal has already generated positive and negative reactions from various corners of the financial services industry: the Independent Community Bankers of America has issued a press release expressing “grave concerns”<sup>2</sup> about the prospect of a federal FinTech charter while Coin Center is “thrilled”<sup>3</sup> by Comptroller Curry’s announcement. Comments on the white paper are due January 15, 2017.

Demographic changes, a desire to reach potential customers that have not traditionally had a bank account (sometimes referred to as the “unbanked”) and advancements in smart phone technology have led to the proliferation of FinTech companies: by the OCC’s estimate, there are now 4,000 FinTech companies in the U.S. and U.K. alone and investments in FinTech companies worldwide over the past five years has increased from \$1.8 billion to \$24 billion. The OCC has been one of the more active banking regulators when it comes to courting FinTech companies: in March of this year, the OCC released a set of principles to guide the development of a framework for responsible innovation; held a public forum in June to discuss the issues surrounding responsible innovation; released a proposal for the resolution of uninsured banks in September, and; in October, established an Office of Innovation, headed by Chief Innovation Officer Beth Knickerbocker, formerly of the American Bankers Association.<sup>4</sup>

The white paper elaborates on how the OCC intends to leverage traditional bank regulatory authorities and supervisory concepts and apply them to the chartering and supervision of FinTech companies. While a FinTech special purpose charter may sound like a revolutionary proposition, the white paper suggests that the OCC will, to the greatest extent possible, strive to treat FinTech charters the same as full-service, brick-and-mortar national banks. The OCC will charter FinTech companies that perform at least one of the traditional activities associated with the national bank charter: lending money, accepting deposits,

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<sup>1</sup> A copy of the white paper can be found at <https://www.occ.gov/topics/bank-operations/innovation/special-purpose-national-bank-charters-for-fintech.pdf>

<sup>2</sup> ICBA, ICBA Expresses Grave Concerns About Proposed FinTech Federal Charter (Dec. 2, 2016), available at <http://www.icba.org/news-events/latest-news/2016/12/02/icba-fintech-charter-should-ensure-level-regulatory-standards>.

<sup>3</sup> Coin Center, The OCC has decided to pursue the federal fintech charter for which we have been advocating (Dec. 2, 2016), <https://coincenter.org/link/the-occ-has-decided-to-pursue-the-federal-fintech-charter-for-which-we-have-been-advocating>.

<sup>4</sup> A collection of the OCC’s FinTech projects can be found on the agency’s website at <https://www.occ.gov/topics/bank-operations/innovation/index-innovation.html>.

providing fiduciary services, and cashing checks. The OCC has commonly found, and the courts have commonly agreed, that “the business of banking develops over time as the economy and business methods evolve.” So it will be with the FinTech charter. Discounting notes, purchasing bank-permissible securities, and engaging in lease-financing transactions are all examples of activities that the OCC has found to be the equivalent of lending money. Other traditional banking activities may also be subject to a more expansive interpretation; according to the white paper “issuing debit cards or engaging in other means of facilitating payments electronically are the modern equivalent of paying checks.” It remains to be seen how far the OCC will push the scope of these traditional banking services. FinTech companies interested in a special purpose national bank charter are encouraged to think creatively about how their services could be characterized as an existing permissible activity.

But a special purpose national bank charter may not be for every FinTech company. Every charter comes with its own unique set of benefits and costs, the scope of which vary with the scope of the FinTech’s businesses. Some of the potential benefits associated with a charter include:

- **Preemption.** FinTech companies with a national bank charter will be treated the same as other national banks when it comes to the preemption of state law, enabling them to potentially simplify their compliance management systems and reduce compliance costs. Additionally, almost all state lending license regimes have carve outs for national banks. So a FinTech lender operating nationwide needs only one national bank charter, instead of fifty state lending licenses.
- **Federal Home Loan Bank Membership.** FinTech companies that deal in residential real estate loans could benefit from membership in a federal home loan bank (“FHLB”). FHLBs can provide reasonably priced sources of credit and liquidity to its members, but are generally not open to companies that do not have a banking charter.
- **CFPB oversight.** FinTech companies that provide “consumer financial products or services” are generally regulated by the Consumer Financial Protection Bureau (“CFPB”). However, if a FinTech company obtains a national bank charter, and its total assets are less than \$10 billion, its primary federal regulator would be the OCC, not the CFPB.
- **Reputation.** Some FinTech companies have taken the position that a banking charter provides them with a marketing advantage over similar competitors who have elected to remain unregulated. For example, itBit, a bitcoin trading platform, trumpets on its webpage that “[b]y establishing the itBit Trust Company through the New York State Department of Financial Services, itBit is regulated to the highest degree, offering a level of customer care superior to any other Bitcoin company.”

Some of the potential costs associated with a charter include:

- **Federal Reserve regulation.** A company that controls a FinTech company with a national bank charter will likely be considered a bank holding company.<sup>5</sup> Bank holding companies are regulated and supervised by the Federal Reserve and are limited in their ability to, directly or indirectly, engage in non-banking activities.
- **CALMA and conditions imposed in writing.** The OCC would likely condition its approval for a FinTech charter on entering into what is called a CALMA (which stands for Capital Assurance and Liquidity Management Agreement), obligating those controlling the charter to provide financial support. The OCC also has the authority to issue other conditions imposed in writing that could limit the FinTech’s ability to achieve its stated business plan, either directly or by increasing regulatory costs. For example, although the Community Reinvestment Act applies only to insured

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<sup>5</sup> FinTech companies should work with counsel to determine whether an exception might apply.

depository institutions, the Comptroller has hinted that uninsured FinTech charters would be required to practice some form of financial inclusion.

- **Supervision.** FinTech charters will be supervised and examined just the same as other national banks. Approximately every 18 months, examiners will request FinTech documents, meet on site with FinTech employees, and issue reports of examinations that set forth their conclusions. If they uncover violations of law or deem the company to be operating in an “unsafe and unsound” manner, they could bring enforcement actions and level civil money penalties.

FinTech companies that seek to accept deposits would need to submit a deposit insurance application to the Federal Deposit Insurance Corporation (“FDIC”) in addition to a bank charter application to the OCC. While the FDIC has only granted six deposit insurance applications in the last five years (and has also been skeptical of monoline business plans), there have been some recent indications that the FDIC would like to promote the creation of more de novo bank charters.<sup>6</sup> As an alternative to chartering a new national bank, FinTech companies wishing to enter the regulated banking sector may also want to consider acquiring an existing bank charter. The principles from the white paper would apply equally to de novo FinTech charters or entry through acquisition, but the timeline for an acquisition may be shorter than the timeline for a de novo, assuming the FinTech company can quickly find a suitable target.

The OCC intends to make comments on the white paper publically available, and will, presumably, release a report summarizing the comments received and providing more guidance on the chartering and supervision of FinTech companies. FinTech companies should review their strategic business plans and consider whether the merits of operating as a national bank exceed the costs. For many FinTech players, we believe there are still benefits of the bank partnership model including the ability to continue conducting nonbanking activities and more modest capital needs than a full-fledged FinTech national bank charter. We believe this model is still in its infancy and as it evolves it may offer untapped opportunities to players in both banking and FinTech.

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<sup>6</sup> See Remarks by FDIC Chairman Martin J. Gruenberg To the FDIC Community Banking Conference “Strategies for Long-Term Success” (Apr. 6, 2016), available at <https://www.fdic.gov/news/news/speeches/spapr0616.html>