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WHITE PAPER

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Fintech Banks—Comptroller of the Currency Proposes New Special Purpose Charter

After a year of study, the Comptroller of the Currency has announced that his agency, the OCC, was moving forward with a proposal to create a special purpose national bank charter for fintech firms. Concurrently, the OCC released *Exploring Special Purpose National Bank Charters for Fintech Companies*, which discusses national bank powers, identifies baseline supervisory expectations, and provides an overview of the OCC's process for reviewing and acting on Fintech Charter applications. Comments are due by January 15, 2017. This *White Paper* discusses these developments, regulatory experience with special purpose bank charters, and how fintech companies may take advantage of the OCC proposal and use special purpose bank charters.

TABLE OF CONTENTS

The Comptroller of the Currency announced on December 2, 2016, that his Office ("OCC") was moving forward with a proposal to create a special purpose national bank ("Fintech Charter") for fintech firms ("Announcement"). The OCC simultaneously released *Exploring Special Purpose National Bank Charters for Fintech Companies* ("Release") (Dec. 2016). The Release discusses national bank powers, identifies baseline supervisory expectations, and provides an overview of the OCC's process for acting on Fintech Charter applications. Comments on the Release are due by January 15, 2017.

The Announcement and Release follow more than a year's work at the OCC to develop a:

> … comprehensive framework to improve the OCC's ability to identify and understand trends and innovations in the financial services industry, as well as the evolving needs of consumers of financial services.[1]

The Comptroller stated that he was most excited about fintech's "… great potential to expand financial inclusion, reach unbanked and underserved populations, make products and services safer and more efficient, and accelerate their delivery." The OCC efforts to facilitate "responsible innovation" will be discussed more fully in a separate paper.

The OCC's work and the Announcement place the OCC in position to facilitate, as well as supervise, financial innovation through banks. The OCC historically has promoted innovation through legal and other interpretations of the National Bank Act to allow banks to adapt to technological and market changes. The OCC has the exclusive authority among the federal bank regulators to charter special or limited purpose banks, including non-depository banks. Fintechs considering a Fintech Charter, especially those that will take deposits, also need to consider the applicability of, and regulation under, the Federal Deposit Insurance Act ("FDI Act") and the Bank Holding Company Act of 1956 ("BHC Act").

The Announcement is a major change from the periodic regulatory and legislative hostility to special purpose charters of the last two decades. During this time, many credit card banks owned by retailers and nonbanks were criticized for asset concentrations and volatile funding through securitizations, the capital markets, and brokered deposits. Non-depository trust companies have been inhibited by confusion over the appropriate capital levels and by how a failure would be handled. All have been affected adversely by the greater regulatory compliance demands imposed on such charters, which were often disproportionate to such banks' relatively small size compared to their parents' nonbanking businesses. Since more than 400 banks failed during the last recession, including a disproportionate number of *de novo* institutions, the Federal Deposit Insurance Corporation ("FDIC") has granted FDIC insurance to only a handful of new charter applicants since 2008.[2] Special purpose industrial loan companies ("ILCs") have been placed in various moratoria and were the subject of a study mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").

SPECIAL PURPOSE CHARTERS

The Release confirms the OCC's authority to grant special purpose national bank charters to fintech and other firms seeking to conduct fiduciary activities, or at least one of three core banking activities—receiving deposits, paying checks, or lending money ("Core Activities"). 12 U.S.C. 1 *et seq*. and OCC Regulations ("OCC Regs.") § 5.20 The OCC has similar broad chartering authority with respect to federal thrifts under 12 U.S.C. 1461 *et seq.* and OCC Regs. § 5.20. Although grandfathered unitary thrift holding companies have been useful to commercial enterprises that have conducted banking business through a thrift, the thrift charter is not as useful as a Fintech Charter, and its use was not discussed in the Announcement or Release.

Special purpose banks primarily have been non-depository trust companies and FDIC-insured credit card banks. The national trust companies are typically used to serve customers in multiple states consistent with state laws limiting the exercise of fiduciary authority by out-of-state institutions and facilitated interstate expansion prior to the Dodd-Frank Act. Credit card banks were exempted from the BHC Act by the Competitive Equality in Banking Act ("CEBA") in 1987. These CEBA credit card banks were widely established by retailers and banks to locate their credit card operations in states with favorable interest rate laws and taxation, and to use 12 U.S.C. 85 to export interest rates across state lines.[3] The OCC has chartered banker's banks engaged exclusively in providing services to or for other depository institutions and holding companies, and their officers, directors, and employees,[4] in addition to cash management banks and community development banks.

Many special purpose charters have been sought to avoid the BHC Act and its limitations on interstate expansion and on commercial, non-banking activities[5] by relying on exceptions from the term "bank" in Section 2 of the BHC Act.

FINTECH MODELS AND THE USE OF A NATIONAL BANK

Fintechs should consider the desirability of bank powers in light of their business models. For example, fintechs providing payment services may primarily seek access to the payments system while avoiding state money transmission licensing and regulation. Such businesses, as well as wealth management and fiduciary services, may not need to take deposits or have FDIC insurance. Marketplace and other lenders may seek bank powers under 12 U.S.C. 85 to charge the same interest rates nationwide and avoid various state usury, lender and money transmitter licensing, and other laws.

Fintech lenders are likely to seek stable funding available through FDIC-insured deposits, where they would be required to obtain FDIC insurance and become subject to FDIC rules, including safety and soundness limitations and FDIC efforts to curb "brokered deposits." Fintech Charters are likely to be scrutinized on loan and funding concentrations, as well as capital. Nondiversified business models may have a more difficult time chartering a bank and, if chartered, may have to maintain substantially more capital. Often credit card banks have 25 percent or greater capital ratios. The Basel III capital rules eliminated securitization gains on sale from regulatory capital, and the risk retention rules effective this month, make it more difficult and costly for limited purpose lenders to rely on securitization lending.

Applicants for a Fintech Charter should consider the OCC securities rules and their ability to make securities offerings, for bank capital and/or funding purposes. The proposed OCC rules for *Receiverships for Uninsured National Banks,* 81 Fed. Reg. 62835 (Sept. 13, 2016), address longstanding OCC issues that have impeded chartering special purpose national banks, but these raise new issues regarding true sales and the structures and legal opinions needed for accounting, securitization, and loan sale purposes.

Activities that are novel or are perceived as risky by the OCC will slow the chartering and/or activity approval processes and may lead to OCC requests for substantially more capital than conventional national banks. Similarly, the Release emphasizes that fintech applicants will need to provide exit plans in case the business stumbles. While these are not the Dodd-Frank Act Section 165(d) resolution plans (living wills), this is a new type of requirement. The OCC's inexperience with this requirement may further slow Fintech Charter applications.

PROPOSED FINTECH NATIONAL BANK CHARTERS

The Release confirms that Fintech Charters will be treated identically to full-service national banks, generally. As a result, fintech companies need to carefully consider what activities are best included in the bank and which are better left outside the bank and OCC regulation, and if possible, outside of coverage by the BHC Act and Federal Reserve regulation of BHCs and their nonbank subsidiaries.

Regulatory considerations applicable to establishing and operating Fintech Charters include:

OCC Chartering Process

The OCC's standard chartering process will apply to applications from fintech companies for a Fintech Charter. Applicants should, however, depending on the complexity of their business model, expect more questions regarding operational risks, internal controls, management's and the board of directors' qualifications and experience in banking, capital and liquidity, the nature of the shareholders, and affiliate and intercompany transactions, etc. than may occur with a traditional full-service national charter. Shareholders, especially those with 10 percent or more beneficial ownership, will be scrutinized carefully. Bank management incentives, including options and warrants in any parent or affiliate, will be considered under the OCC policy and may be limited. *See* OCC Charter Manual, pp. 19 and 20 and Appendix B. This is an area that will require further thought and possible revision by the OCC and applicants for Fintech Charters due to the typical equity incentives in tech companies versus those permitted to *de novo* national banks.

Business Plan

The OCC expects a fintech company to clearly articulate why it is seeking a Fintech Charter and provide significant detail about its activities, management, shareholders, capital, risk management systems, and may inquire in detail as to systems, financial and credit models, data security and privacy, including cybersecurity, and outside vendors. A business plan should be comprehensive, reflecting in-depth planning by the organizers, board of directors, and management. The OCC Charter Manual has detailed information on business plans. If deposits are to be taken, the FDIC's policies on business plans and new charters also should be considered.[6] Changing business plans, especially for *de novo* banks, requires prior regulatory approval, which is neither quick nor easy, and the business plans should anticipate and provide for technological changes.

Corporate Structure

The corporate organization and structure provisions of the National Bank Act will apply to the Fintech Charter.

Governance

The bank's board of directors must have a prominent role in the overall governance, including settling the bank's risk appetite and risk management framework. Board members also must actively oversee management, provide credible challenge, and exercise independent judgment. Management should have significant bank as well as tech experience, as should the bank's board. Directors should be aware of their responsibilities and potential liabilities as bank directors.

Capital

Fintech Charter applicants whose business activities may be off-balance sheet will be subject to the OCC's minimum regulatory capital requirements. The minimum regulatory capital levels may not adequately reflect the risks associated with off-balance sheet activities. Applicants are expected to propose a minimum level of capital that the Fintech Charter would meet or exceed at all times, which adequately reflects the bank's risks.

Liquidity

The OCC evaluates bank liquidity, including its access to stable funding, as well as its funding costs. Liquidity management should address the effects on earnings and capital and should incorporate planned and unplanned balance sheet changes, as well as varying interest rate scenarios, time horizons, and market conditions. Applicants in the current environment should address the anticipated effects of rising rates in their interest rate risk management plans. *See Comptroller's Handbook—Liquidity* (Sep. 2012).

Permissible Activities

The Release states that the OCC will consider on a case-by-case basis the permissibility of new activities proposed for a Fintech Charter. Although approvals of new activities have been restrained in recent years, the OCC believes that the National Bank Act is sufficiently flexible to permit national banks to engage in new activities as part of the business of banking or to engage in traditional activities in new ways. *See* OCC Regs. § 12 C.F.R. 7.5002 (regulation authorizing national banks to use electronic means to conduct otherwise permissible activities, subject to appropriate safety and soundness and compliance standards and conditions). The *OCC Summary of the Powers of National Banks and Federal Savings Associations* (Aug. 2011) highlights permissible activities.

Systems and Vendor Management

Systems, including those provided by third-party vendors, should be operated in accordance with the Federal Financial Institutions Examination Council's IT Handbooks. Data privacy and cybersecurity are leading OCC concerns, especially for fintech businesses. Vendor management is another important responsibility of bank management.

Rules and Standards

Generally, a Fintech Charter will be held to the same standards of safety and soundness, fair access, and fair treatment of customers that apply to all national banks. These include the same laws, regulations, examinations, reporting requirements, and ongoing supervision as other national banks, including statutes and regulations on legal lending limits and limits on real estate holdings, anti-money laundering laws and the Bank Secrecy Act (collectively, "AML/BSA"), the U.S. Treasury's Office of Foreign Asset Control's ("OFAC") trade and economic sanctions, Section 5 of the Federal Trade Commission Act ("FTC Act"), and Sections 1031 and 1036 of the Dodd-Frank Act. The OCC typically has required credit card banks to enter into operating agreements requiring significantly greater capital and liquidity than ordinary national banks, as well agreements specifying required parent company capital and liquidity support.

Community Service and Financial Inclusion

Although the Community Reinvestment Act ("CRA") applies only to FDIC-insured institutions, the OCC expects all applicants, whether FDIC-insured or not, that engage in lending activities to demonstrate a commitment to providing fair access to financial services by helping to meet the credit needs of their communities, and commitments to financial inclusion that support fair access to financial services and fair treatment of customers. Developing a business plan that satisfactorily includes such services and documenting the bank's performance under this plan require careful, continuing work.

Compliance

"Consumer financial products or services regulated under Federal consumer financial laws" are regulated by the Consumer Financial Protection Bureau ("CFPB"), which has the authority to issue regulations and interpretations of consumer finance and fair lending laws, pursuant to Section 1011(a) of the Dodd-Frank Act. The CFPB has supervisory authority and primary enforcement authority over banks that have assets greater than $10 billion. 12 C.F.R. § 5515. Fintech companies offering consumer products will be subject to the consumer financial laws and rules and OCC supervision but will not be subject to CFPB examination until they reach $10 billion in assets. *See* 12 U.S.C. 5516 and 5581(c)(1)(B).

Compliance Risk Management

A Fintech Charter applicant is expected to demonstrate a culture of compliance that includes a top-down, enterprise-wide commitment to understanding and adhering to applicable laws and regulations and to operating consistently with OCC supervisory guidance. A compliance program should be designed to ensure and monitor compliance with AML/BSA requirements, OFAC sanctions, the FTC Act and the Dodd-Frank Act provisions regarding unfair, deceptive, or abusive acts or practices, as well as all applicable fair lending and consumer financial protection laws and regulations, including CFPB guidence and enforcement precedent. The OCC will consider how innovative elements of a Fintech Charter applicant's business model may affect the proposed bank's compliance risk profile.

Production Incentives

Federal Reserve guidance, Interagency Dodd-Frank Act, Section 956 proposals, and CFPB Compliance Bulletin 2016-03, *Detecting and Presenting Consumer Harm from Production Incentives* (Nov. 28, 2016) should be considered in developing incentives to promote growth without undue risk.[7]

State Regulation

Fintech companies will benefit from a Fintech Charter in certain respects, especially in terms of state licensing and usury laws. Other state laws are applicable to national banks. The Dodd-Frank Act, Section 1044 altered the preemption framework with respect to state consumer financial protection laws, other than interest rates under 12 U.S.C. 85. Under Section 1044 of the Dodd-Frank Act, a state consumer financial protection law may be preempted by the OCC only if: (i) the law would have a discriminatory effect upon national banks; (ii) the law prevents or significantly interferes with the exercise by the national bank of its powers; or (iii) the law is preempted by any other provision of federal law. In addition, the OCC is required to make determinations regarding preemption of state laws on a case-by-case basis and can no longer provide blanket preemption determinations. The Dodd-Frank Act also gives state attorney generals the power to enforce against national banks rules and regulations promulgated by the CFPB.[8]

Recovery and Exit Strategies

Business plans must articulate specific financial or other risk triggers that would prompt a Fintech Charter's board of directors and management to unwind the operation in an organized manner. The business plan must address material changes in the institution's size, risk profile, activities, complexity, and external threats, and be integrated into the entity's overall risk governance framework. A plan should include a wide range of credible options an entity could take to restore its financial strength and viability, and escalation and notification procedures.

Federal Reserve Regulation

As national banks, Fintech Charters will be required to become members of the Federal Reserve System. 12 U.S.C. 222 and 466. Hence, most nationally chartered fintech companies will be subject to Federal Reserve regulations, especially Federal Reserve Regulation W regarding affiliate transactions, including service contracts with the bank.

BHC Act Regulation

If the Fintech Charter will be owned or otherwise "controlled" by an entity and the fintech company is a "bank" for purposes of the BHC Act, then the BHC Act and Federal Reserve Regulation Y ("Reg. Y") would also apply and affect the Fintech Charter application. *See* OCC Charter Manual, pp. 6 and 108. If applicable, the BHC Act will limit the activities of the Fintech Charter's parent and the parent's nonbank subsidiaries to those that are "so closely related to banking to be a proper incident thereto." BHC Act, Section 4(c)(8).

CHARTERING PROCESS AND TIMING

The OCC will apply its standard charter review and decision process for Fintech Charter applications. If one or more BHCs are involved, the Federal Reserve typically does not consider applications with respect to de novo banks until the OCC grants preliminary conditional approval. A deposit charter will take FDIC approval of deposit insurance, as well.

The OCC recognizes that it may need to tailor some requirements that apply to a full-service national bank to address the business model of a special purpose national bank. The OCC's new Office of Innovation also is intended to be a resource to fintech companies interested in exploring the possibility of a Fintech Charter. Early conferences with the OCC by well-prepared applicants knowledgeable on the business model, risks, and legal and bank regulatory issues are desirable and encouraged.

Applicants for Fintech Charters should expect the process to take at least nine to 12 months and likely substantially more. Applicants should expect the OCC to impose commitments and conditions reflecting the proposed business plan and its risks.

POTENTIAL BANK HOLDING COMPANY ACT ISSUES

Limited purpose charters have a history of being used to avoid being a "bank" for BHC Act purposes. The Federal Reserve historically has sought to maintain the separation between commerce and banking, limit nonbank participation in the payments systems, and prevent avoidance of BHC Act regulation.

A "bank holding company" ("BHC") is an entity which is a "company" and which has "control" of a "bank." BHC Act, Subsections 2(a)(1) and (2), 2(b) and 2(c). A BHC is subject to supervision and regulation by the Federal Reserve under the BHC Act.

Whether a Fintech Charter is a "bank" for BHC Act purposes depends upon its activities. BHC Act Section 2(c) defines a "bank" as an "insured bank" under Section 3(h) of the Federal Deposit Insurance Act ("FDI Act"), *or* as an institution that: (i) accepts demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others; and (ii) is engaged in the business of making commercial loans. If the Fintech Charter applicant takes deposits, it would be FDIC-insured, and any controlling entity would be a BHC under the BHC Act. The current definition of a "bank" reflects action by the Federal Reserve and resulting litigation to prevent owners of special purpose banks from evading the BHC Act.[9]

If a controlling entity would be a BHC Act "company" upon formation of the Fintech Charter, an application for approval as a BHC would have to be made with the Federal Reserve and approved prior to the bank commencing business. A BHC would have to conform its activities to those permitted to BHCs and must serve as a source of strength to any depository subsidiaries. Certain controlling shareholders, such as private equity or venture capital funds of the fintech company, may not be able or willing to be regulated as BHCs. The fintech company's shareholder base has to be carefully evaluated up front.

Any person or entity that seeks to "control" a Fintech Charter or its parent company would be subject to extra scrutiny in the OCC chartering process. If control of a depository Fintech Charter or its parent is sought after chartering, the acquirer would have to file a public notice under the Change in Bank Control Act and obtain regulatory notice of "intent not to disapprove" prior to acquiring control. This may complicate future financing rounds and relationships with lead or potential lead investors who will consider the consequences of an investment through a BHC in a Fintech Charter. Such consequences include all BHC parents serving as a source of strength to a depository bank, and shareholders who have been "approved" under the Change in Bank Control Act being potentially liable to regulators as "institution affiliated persons," under FDI Act Section 3(u).

THE FEDERAL RESERVE ON FINTECH

The Federal Reserve recognizes, in principle, the consumer opportunities of fintech and the risks of pushing fintech outside the regulated banking industry. On the same day as the Announcement, Federal Reserve Governor Lael Brainard appeared at the Federal Reserve's Conference on Financial Innovation to discuss fintech. Similar to the OCC, the Federal Reserve consults with other regulators and seeks to understand fintech, and insists upon risk management, compliance and consumer protection, and broad inclusion and social benefits. The Federal Reserve has a multidisciplinary working group, including supervision, community development, financial stability, and payments experts that is evaluating the effects of technological developments on financial services delivery and the policy and supervisory implications. Governor Brainard's remarks were similar to the Comptroller's and reflect consistent themes:

> … it is important that regulators and supervisors not impose undue burdens on financial innovations that would provide broad social benefits responsibly. An unduly rigid regulatory or supervisory posture could lead to unintended consequences, such as the movement of innovations outside of the regulated banking industry, potentially creating greater risks and less transparency.
>
> Fundamentally, financial institutions themselves are responsible for providing innovative financial services safely. Financial services firms must pair technological know-how and innovative services with a strong compliance culture and a thorough knowledge of the important legal and compliance guardrails. *While "run fast and break things" may be a popular mantra in the technology space, it is ill-suited to an arena that depends on trust and confidence.* New entrants need to understand that the financial arena is a carefully regulated space with a compelling rationale underlying the various rules at play, even if these are likely to evolve over time. There is more at stake [to consumers] in the realm of financial services than in some other areas of technological innovation. (emphasis added).

Echoing the Comptroller and the FDIC's long-term efforts to encourage banks to make small balance loans and serve the underbanked, Governor Brainard emphasized:

The challenge will be to foster socially beneficial innovation that responsibly expands access to credit for underserved consumers and small businesses, and those who otherwise would qualify only for high-cost alternatives. It would be a lost opportunity if, instead of expanding access in a socially beneficial way, some fintech products merely provided a vehicle to market high-cost loans to the underserved, or resulted in the digital equivalent of redlining, exacerbating rather than ameliorating financial access inequities.

Green Dot Lessons

The Federal Reserve's approval of Green Dot Corporation's acquisition of Bonneville Bancorp (Nov. 23, 2011) illustrates factors the OCC and other bank regulators may consider in Fintech Charter proposals. Green Dot, a nonbank, was engaged in selling general purpose reloadable prepaid cards ("GPR Cards"), mostly through one large retailer. Green Dot sought to use Bonnevillle's bank subsidiary to conduct its GPR business and related payment transfers business.

The Federal Reserve's approval order stated that:

> A business plan that focuses on a narrow business activity and depends on a limited number of key business partners carries significantly greater risks than a business plan that employs broad diversification of activities and counterparties. The Board expects banking organizations with a narrow focus to address these increased risks with financial resources, managerial systems, and expertise commensurate with that additional level of risk.

Green Dot committed to maintain 15 percent Tier 1 leverage capital and to hold cash equal to its deposits generated from the GPR cards. In an unusual dissenting statement, one Federal Reserve Governor made the following observations, especially about the sustainability of the technology and business model, which should be considered by any fintech seeking to enter the banking industry:

> The prepaid debit card industry is subject to various risks, including the possibility that the technology currently employed by industry participants could become obsolete, that consumers' demand for prepaid debit cards as an alternative to more traditional banking products and services could decline, that potential legislative or regulatory changes could reduce or eliminate the profitability of issuing prepaid debit cards, and that

> competition in the prepaid debit card industry may increase as a result of full-service banking organizations entering the market. In addition, the business model employed … involves significant exposure to operational, concentration, consumer, counterparty, settlement, and compliance risks. Moreover, in addition to the increased risks presented by a business plan focused on a narrow business activity, Green Dot currently relies on a single retail partner for a large majority of its revenues, and a loss of the relationship would have a materially adverse impact on Green Dot's revenues.

EXPERIENCE WITH SPECIAL PURPOSE CHARTERS

The OCC, as well as various states, have a long history of issuing special purpose charters to banks and non-bank financial institutions that offer commercial and industrial loans, credit cards, internet and electronic banking, and trust and fiduciary services. The OCC's Fintech Charter initiative should be considered in light of the history of special purpose charters and the concerns these have raised.

As of August, 31, 2016, there were only nine credit card banks operating under a special purpose national bank charter. The number of industrial loan companies has declined more than 50 percent since 2006, dropping from 58 to 25. A host of factors have led to the decline in special purpose institutions, including supervisory pressures to conform to full service bank supervisory standards, the risks of limited product lines, credit and funding concentrations, the perceived volatility and periodic unavailability of securitizations, debt securities and brokered deposits, competitive pressures from full-service banks, and the costs of regulation, especially to parent companies whose primary businesses are commercial or nonbanking.

In the past, bank regulators have been hesitant to issue special purpose charters due to safety and soundness concerns. The Federal Reserve has sought to exclude commercial entities from the financial system because, the Federal Reserve has argued, these permit an inappropriate commingling of banking and commerce outside of the framework of the BHC Act. *See* Melanie L. Fein & Pauline B. Heller, *Federal Bank Holding Company Law* at § 2.03 (2016). In 2006, the FDIC imposed a six-month moratorium on applications for deposit insurance by ILCs, as well as on notices of Change in Bank Control Act notices for existing ILCs. ILCs are not "banks" under the BHC Act and are a type of special purpose charter that allows commercial firms to own and operate an FDIC-insured lender. When the FDIC commenced the moratorium, there were 14 applications pending for action by the FDIC. Commercial firms had filed nine of these applications, in many cases seeking access to the payments system and lower card processing costs.

In January 2007, the FDIC extended the existing moratorium on all ILC applications by commercial companies for an additional year to allow Congress to determine whether such acquisitions should be prohibited. This FDIC's moratorium expired in 2008, without any new legislation.

Dodd-Frank Act, Section 603 imposed a three-year moratorium that prevented the FDIC from approving any applications for FDIC insurance for ILCs, credit card banks, and trust banks that are owned or controlled by a commercial firm. The moratorium also prevented the banking regulators from approving any applications for change in control of nonbank banks under the Change in Bank Control Act, with certain exceptions.

In addition to the new moratorium, Section 603 of the Dodd-Frank Act required a study by the Government Accountability Office ("GAO") of the regulatory implications of special purpose bank charters. The GAO's report did not recommend that Congress repeal the federal law provisions that allow ownership of ILCs and special purpose credit card banks by commercial firms. *See* GAO, *Bank Holding Company Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing Exemptions* (Jan. 2012). The GAO report noted that the regulators with primary authority over the institutions—the OCC in the case of most credit card banks, and the FDIC in the case of ILCs—indicated that supervision of the exempt institutions themselves was adequate, although the FDIC acknowledged that consolidated supervision authorities provide important safety and soundness safeguards. The Federal Reserve and the Treasury Department took a different view, contending that these exceptions from the BHC Act should be removed, given that excepted institutions have access to FDIC insurance and their holding companies generally are not subject to consolidated supervision.

It is yet to be seen whether the fintech industry will reignite similar public policy and interagency debates as it continues to grow and become more deeply intertwined with the banking industry.

CONCLUSIONS

The OCC's Fintech Charter proposal is a major shift that creates opportunities for fintechs, especially those looking to enter the payments system or provide wealth management and fiduciary services. Equally significant, the Release is part of the OCC's larger framework for responsible innovation. The framework applies not just to non-banks, but the OCC has made it clear that all banks should include financial innovation as part of their strategic and business planning.

The proposal's advantages for fintech lenders appear narrower. A special purpose lending bank typically uses deposits to fund its loans, to avoid undue reliance on debt securities and securitizations that are subject to market vagaries. Deposit taking makes a bank similar to a full-service bank, and it will require FDIC approval of the new charter, as well as Federal Reserve approval of any entity controlling the bank as a BHC. The FDIC has been reluctant to approve insurance for *de* novo banks since 2008. The Federal Reserve has been cautious to maintain the separation of banking and commerce and to limit non-bank entry in the payments system. These concerns, and the application of all the OCC's existing rules and policies to special purpose banks, raise the question of whether it would be easier to buy an existing bank and obtain approval to change its business plan, rather than trying to create new precedent by building a special purpose charter that has FDIC insurance and where the parent is regulated as a BHC by the Federal Reserve.

A fintech business's overall business plan and the activities to be conducted by the Fintech Charter and its affiliates should be considered carefully. Similarly, care should be used to evaluate whether or not the fintech company and its controlling entities are eligible and willing to become a BHC under the BHC Act.

A fintech lending institution that does not take deposits likely will not have funding viewed as "stable" by the OCC. A concentration of assets in one type of credit, with funding through unpredictable securitization and debt funding, may lead to an OCC charter denial or very high capital levels. A bank that is engaged only in making loans and holding them for a brief time before they are sold could also raise the types of questions that led to the *Madden* case and "true lender" questions and secondary loan market uncertainty.[10]

Anyone considering applying for a Fintech Charter under the proposed rules should organize an experienced team of bankers and advisors. The culture of the fintech industry and the culture sought by the bank regulators may clash on issues of specific products, speed, flexibility in changing business plans, efficiency, and the need for growth. Compensation, including incentive and production compensation, likely will be an issue that all will have to confront in the fintech chartering process and on an ongoing basis. Compliance and community service generally will be new to fintech companies and to the OCC. Fintech Charters will have to document their service to the communities and be inclusive in their product offerings. Services to promote social benefits and inclusion may raise documentation, credit, and profit concerns. Careful consideration of these efforts in advance with the OCC, and avoidance of high interest rate products with multiple rollovers similar to "payday loans," is advisable.

The OCC's Fintech Charter proposal and its framework for responsible financial innovation are significant, positive changes. These offer opportunities that may not otherwise exist, but that should be considered in the broader scope of regulation applicable to any national bank and the historical positions of the other federal bank regulators. As the Comptroller and Federal Reserve Governor Brainard have noted, both the regulators and the fintech industry will have to adapt their cultures to accommodate innovation to enable fintech companies to own and operate banks and provide customers the benefits of technological developments.

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ENDNOTES

1 OCC, *Supporting Responsible Innovation in the Federal Banking System* (March 2016), quoting from Remarks by Thomas J. Curry, Comptroller of the Currency, Before the Federal Home Loan Bank of Chicago (Aug. 7, 2015).

2 FDIC insurance is required for national banks and most state banks that take deposits other than trust funds. See FDI Act Section 5(a)(1), FDIC Regs. Part 303, Subpart B, and OCC Regs. § 5.20. As a result, deposit-taking national banks require prior FDIC, as well as OCC, approval.

3 *Marquette Nat. Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978).

4 12 U.S.C. 24 (Seventh) and 12 C.F.R. § 5.20(d)(1). OCC Licensing Manual-Charters-Glossary (Sept. 2016) ("OCC Charter Manual").

5 *See Board of Governors of Federal Reserve System v. Dimension Financial Corp.*, 474 U.S. 361 (U.S. 1986). *See also* BHC Act, Section 4 and Federal Reserve Regulation Y ("Reg. Y") § 225.86.

6 *See* FDIC Business Plan Guidelines (Dec. 12, 2001), FDIC Statement of Policy on Applications for Deposit Insurance (Jul. 7, 1998), and Supplemental Guidance related to FDIC Statement of Policy on Applications for Deposit Insurance (Apr. 6, 2016).

7 Dodd-Frank Act, Section 956 and Interagency Notice of Proposed Rulemaking, "Incentive-Based Compensation Arrangements" 81 F.R. 37669-37838 (June 10, 2016); Interagency Guidance on Sound Incentive Compensation, 75 F.R. 36395 (June 25, 2010) ("Final Incentive Guidance"); and "Incentive Compensation," Testimony before the House Committee on Financial Services by Scott G. Alvarez, General Counsel Federal Reserve (Sept. 24, 2010).

8 Dodd- Frank Act, Section 1047.

9 *See Board of Governors of Federal Reserve System v. Dimension Financial Corp.*, 474 U.S. 361 (U.S. 1986); *First Bancorp v. Board of Governors*, 728 F.2d 434 (10th Cir. 1984); and *Wilshire Oil Co. v. Board of Governors of Federal Reserve System*, 668 F.2d 732 (3rd Cir. 1981) cert. den'd 457 U.S. 1132 (1982).

10 *Madden v. Midland Funding, LLC*, 786 F. 3d 246 (2nd Cir. 2015) cert. den'd 136 S. Ct. 2505 (2016).