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WHITE PAPER

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The OCC's Responsible Innovation Framework and Fintech Bank Charters—Latest Developments

The Comptroller of the Currency (“OCC”) has developed a “Responsible Innovation Framework,” which provides a comprehensive approach to encouraging financial innovation, including innovative products and services. The Framework supports the OCC proposal to charter special purpose fintech national banks and the OCC’s December 2016 resolution rules for nondepository national banks. This *White Paper* discusses the Framework, the changes in the OCC and its processes to foster innovation, and the OCC’s efforts to assist and better inform financial services providers, including community banks and nonbanks, about fintech, innovation, and banking “rules of the road,” among other related topics. This *White Paper* complements a previous Jones Day *White Paper*, “Fintech Banks—Comptroller of the Currency Proposes New Special Purpose Charter” (Dec. 2016), which discusses the proposed fintech bank charter and other special-purpose banks in detail.

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The Comptroller of the Currency (“OCC”) has been working for more than a year 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 evolving customer needs.¹ The OCC is taking a comprehensive approach to financial innovation, including innovative products and services. As part of this initiative, the OCC formed a team including policy experts, examiners, lawyers, and others (“Team”) to gain a better understanding of emerging technology and new approaches in financial services and to design the OCC’s framework for evaluating financial innovation.

The OCC recognized that nonbank financial technology (“fintech”) companies have attracted substantial investment and provide traditional bank services and products to meet customer needs and preferences with new technologies and processes:

...nonbanks have raised consumer expectations by expediting decisions and offering real-time, cross-channel capabilities and a more seamless experience. As a result, consumers are more willing to use multiple channels and providers to meet their needs. New entrants into the market must not engage in unfair and deceptive practices or discriminatory activities.²

This *White Paper* should be read together with our previous *White Paper*, “[Fintech Banks—Comptroller of the Currency Proposes New Special Purpose Charter](#)” (Dec. 2016) (“Jones Day Fintech Charter *White Paper*”). Our earlier *White Paper* discusses the experience with special-purpose bank charters and their regulation, and how fintech companies and others may take advantage of the OCC proposals and use special-purpose bank charters.

RESPONSIBLE INNOVATION PROPOSAL

The OCC’s *Supporting Responsible Innovation in the Federal Banking System: an OCC Perspective* (“Responsible Innovation Proposal”) (Mar. 2016) considered the development of fintech and its effects on the banking system. The Responsible Innovation Proposal expressed the OCC’s views and initiatives intended to provide federally chartered banks and thrifts a regulatory framework that is receptive to responsible innovation and the supervision that supports it.

The OCC defines “responsible innovation” as:

The use of new or improved financial products, services, and processes to meet the evolving needs of consumers, businesses, and communities in a manner that is consistent with sound risk management and is aligned with the bank’s overall business strategy.

Responsible innovation emphasizes the importance of financial institutions being receptive to technological innovation, while emphasizing risk management and corporate governance. The OCC’s guiding principles for financial innovation (“Guiding Principles”) are:

- Support responsible innovation;
- Foster an internal culture receptive to responsible innovation;
- Leverage agency experience and expertise;
- Encourage responsible innovation that provides fair access to financial services and fair treatment of consumers as required under Section 314 of the Dodd-Frank Act;
- Further safe and sound operations through effective risk management;
- Encourage banks of all sizes to integrate responsible innovation into their strategic planning;
- Promote ongoing dialogue through formal outreach; and
- Collaborate with other regulators.

THE RESPONSIBLE INNOVATION FRAMEWORK

After reviewing Team proposals and public comments on its Responsible Innovation Proposal, the OCC issued its *Recommendations and Decisions for Implementing a Responsible Innovation Framework* (Oct. 2016) (“Framework”), consistent with the Guiding Principles.

The OCC has created the Office of Innovation (“Office”), which will be responsible for implementing the Framework. This Office is expected to begin operations in the first quarter of 2017, and it will serve as a central point of contact and facilitate responses to inquiries and requests. The Office will be headed by the Chief Innovation Officer, supported by an Innovation Technician and regional Innovation Officers in New York, San Francisco, and Washington, D.C. Additionally, a Responsible Innovation

Committee, comprising Deputy Comptrollers or Directors from OCC business units, is being formed to build support for the Framework and related activities and to disseminate information regarding innovation throughout the OCC.

The Office will assist in implementing the following recommendations:

- Establish an outreach and technical assistance program;
- Conduct awareness and training activities;
- Encourage coordination and facilitation;
- Establish an innovation research function; and
- Promote interagency collaboration.

The Framework is broader than fintech charters and fintech service providers. It seeks to heighten all banks' awareness of new technologies and raise regulatory understanding of fintech and its challenges and disruptive effects on banks. The Framework states that it is:

... imperative for [banks] to understand the impact of the evolving landscape on their business strategies and leverage their unique advantages so they can continue to meet the needs of their customers, businesses, and communities.

Banks of all sizes are increasingly partnering with fintechs, as both banks and fintechs recognize the benefits of collaboration. Some community banks, however, have not developed an innovative strategy.³

The OCC believes that financial innovation should be part of banks' strategic and operating plans, whether directly or through nonbank service providers.

The Framework recognizes that to achieve its goals:

... it is important that the OCC improve its ability to identify and understand trends and innovations in the financial services industry. This includes not only understanding the new products and services offered and processes implemented by banks, but also the evolving needs of consumers ... and demographics driving the changes in the financial industry. The pace, magnitude, and volume of change means that regulators need to learn and understand the changes as they occur, in a

manner that allows them to anticipate the impact to the federal banking system.

The Framework recommended that the OCC improve the knowledge and training of its staff generally in this area and hire people with appropriate skills in engineering, information technology, systems development, cybersecurity, and mathematical modeling. This will enable the OCC to appropriately understand and supervise national banks and their vendor relationships. At the same time, the Framework seeks to assist these institutions in meeting OCC expectations by providing technical assistance to banks—especially community banks, which may need more resources—and nonbanks, and helping them manage their relationships and implement effective innovation strategies. The Framework further seeks to provide guidance for banks and nonbanks on regulatory principles, processes, and expectations, as well as “rules of the road” for nonbanks.⁴

The Framework also seeks to improve the OCC's “transparency and timeliness of decisions related to innovative products, services and processes.” Several actions are being taken to improve decisions, including creating:

- Specific response and disposition expectations for innovation inquiries and requests, including communication standards for written and verbal inquiries and requests for inquiries, as well as tracking of inquiries; and
- Standard workflows for inquiries and requests for new products, processes, and services, including specific time frames and responsible parties.⁵

The new Office will be responsible for managing the process, but decisions will continue to be made by the groups within the OCC responsible for such matters, such as licensing, legal, etc.

PROPOSED RULE ON OCC RESOLUTION OF UNINSURED NATIONAL BANKS

One impediment to fintech and other special-purpose national bank charters has been the lack of resolution processes for nondepository national banks not eligible for FDIC receiverships. The Federal Deposit Insurance Act (“FDI Act”) requires the OCC to appoint the FDIC as the receiver for all insured national banks, but it does not address the receivership of uninsured national banks.

While it was developing the Framework, the OCC issued a notice of proposed rulemaking designed to address how the OCC would conduct the receivership of uninsured nationally chartered financial institutions (“Proposed Resolution Rule”).⁶

The OCC’s Final Rule on Receiverships of Uninsured National Banks adopted the Proposed Resolution Rule without changes, and it is effective January 19, 2017.⁷ The Final Rule provides the OCC with receivership powers similar to the FDIC’s receivership powers under the FDI Act. Most significantly, the Final Rule facilitates innovation and the special-purpose charter for fintechs and other nondepository banks, and may provide capital relief for uninsured trust companies. The OCC historically has required more capital for nondepository trust companies in the absence of receivership standards, and the new rule should facilitate reasonable capital for fintech and other special-purpose national banks consistent with their business plans, complexity, and risks.

FINTECH CHARTERS

On December 2, 2016, the OCC released *Exploring Special Purpose National Bank Charters for Fintech Companies* (Dec. 2016) (“Fintech Charter Proposal”), which discusses special-purpose national bank charters for fintech companies.⁸

Banks and state regulators have expressed various concerns since the OCC introduced its Framework and the Fintech Charter Proposal, which OCC Chief Counsel Amy Friend has addressed in various forums, including *American Banker*.⁹ Many worry that nationally chartered fintech companies will not be subject to the rules applicable to traditional banks and that the fintech chartering process will be ad hoc. Chief Counsel Friend responded that all national charter applicants, not just fintech companies, will be subject to the rules and procedures outlined in the OCC Chartering Manual and to the rules applicable to traditional banks. The OCC’s baseline expectation is that fintech charter applicants will provide capital, liquidity, sound governance, and a robust business plan.

The OCC intends to propose a policy later this month for fintech charter applications that will supplement the OCC Chartering Manual and will adopt other policies consistent with the Framework that apply to chartering special-purpose

national banks. Applications for fintech charters will not be taken until the chartering policy is finalized. The chartering process will be robust and require pre-filing conferences with the OCC. Approvals are expected to be conditioned on the applicants providing business plans that demonstrate a likelihood of success of the business and on the applicants and potentially their parents entering into operating and similar agreements with the OCC.¹⁰

Once chartered, Chief Counsel Friend has stated that fintech charters will be subject to all laws, regulations, examinations, reporting requirements, and ongoing supervision applicable to national banks, generally. These include legal lending limits, limits on real estate holdings, anti-money laundering laws and the Bank Secrecy Act, and the U.S. Treasury Office of Foreign Asset Control’s sanctions. Other laws that apply to banks and nonbanks will also apply to fintech charters, where compliance will be subject to OCC supervision, examination, and enforcement. Examples of such laws include Section 5 of the Federal Trade Commission Act (unfair or deceptive acts or practices), Dodd-Frank Act Section 1031 (unfair, deceptive, or abusive acts or practices), and Dodd-Frank Act Section 1036, which makes it unlawful “to offer or provide to a consumer any financial product or service not in conformity with Federal consumer financial law, or otherwise commit any act or omission in violation of a Federal consumer financial law.”

Other laws and regulations will apply to fintech banks only to the extent that these engage in a regulated activity or take deposits. For example, the Community Reinvestment Act applies only to FDIC-insured depository institutions. The OCC, however, has indicated that it expects all applicants, whether FDIC-insured or not, that engage in lending activities to demonstrate a commitment to helping meet the credit needs of their communities and to financial inclusion that supports fair access to financial services and fair treatment of customers.¹¹

State bank regulators have expressed concerns that the OCC may exceed its authority by supervising fintech companies because “performing one of the functions of a bank does not make it a full bank.” Ms. Friend believes that the National Bank Act only requires a firm seeking a national charter to engage in “bank-permissible activities.” The OCC has the authority to determine what activities are within the business of banking, and over the more than 150 years of its history, the OCC has

used this authority to find that new activities, or traditional activities using new technology, are bank permissible. OCC rules require that special-purpose banks engage in one of three core banking activities: taking deposits, paying checks, or lending money. The OCC has discretion to determine the activities that are within these three core banking activities, all of which can evolve with technology and business over time to include many activities of fintech companies.

The Roles of Other Regulators

The OCC is consulting with the other federal banking regulators, including the CFPB, on fintech and special-purpose charters. The FDIC must approve deposit insurance for any bank applicant that seeks to take deposits. Fintech lenders are likely to find depository charters most advantageous or even necessary. The FDIC's Division of Risk Management Supervision recently issued *Applying for Deposit Insurance—A Handbook for Organizers of De Novo Institutions* (Dec. 2016) to help potential organizers of new institutions, like fintech companies, become familiar with the deposit insurance application process.

State fintech charters may also be possible. Most states currently require banks to be FDIC insured, and special legislation may be needed to charter and operate nondepository state fintech banks. Fintechs engaged in payment activities may find a national or state charter useful to avoiding multistate money transmission licensing and regulation. Fintech lenders likely will find a depository charter (national or state) most useful to fund loans and export interest rates on an interstate basis under National Bank Act Sections 85 and 86 and FDI Act Section 27. Any state depository bank charter would need FDIC approval, as well as state approval.

Any national bank must be a member of the Federal Reserve System.¹² Federal Reserve Regulation H does not apply to national bank members, although Federal Reserve Regulation I does apply. Federal Reserve Regulation A permits Federal Reserve Banks discretion to allow qualified FDIC-insured institutions to access Federal Reserve Bank advances and to discount paper at the Federal Reserve Bank. It is unclear whether these services and other Federal Reserve services will be permitted to national fintech charters in light of the Federal Reserve's historical concerns over special-purpose charters. Federal Reserve Act Sections 23A and 23B apply to affiliate transactions with any Federal Reserve member bank or any uninsured bank or savings association.

"Companies" that "control" fintech banks that take deposits will be subject to the Bank Holding Company Act of 1956 ("BHC Act") and its activity limitations, and to supervision and regulation by the Federal Reserve. If a parent company is involved, a depository fintech charter applicant will need Federal Reserve approval under the BHC Act before beginning business.

As more fully discussed in the Jones Day Fintech Charter *White Paper*, the Federal Reserve historically has been reluctant to allow nonbanks access to the payments system. The Federal Reserve made various statements in the *Interagency Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act* (December 2016) related to industrial loan companies and grandfathered unitary savings and loan companies that reflect other Federal Reserve concerns over the separation of banking and commerce and the potential concentration of economic power, the effectiveness of supervision of nondepository banks and their parent companies outside the BHC Act, and competitive equality among banking organizations. These concerns may affect the Federal Reserve's views of certain fintech charter proposals.¹³

The Federal Reserve has been less concerned about nondepository trust companies primarily engaged in traditional trust activities that do not obtain payment services or borrowing privileges from the Federal Reserve.

CONCLUSIONS

The OCC is trying to better understand financial innovations and anticipate change. The Framework seeks to change the OCC and provide processes and personnel that can assist banks and nonbanks offering innovative financial products and services, as well as to better supervise such products and services conducted by national banks directly or with nonbank service providers. The Framework and the new OCC Office of Innovation should improve the transparency and timeliness of the OCC's evaluation of financial innovation proposals, including fintech charters. While fintech and fintech charters have received the most attention, the Framework provides that every bank should consider financial innovation and its effects in their strategic plans. Planning and adapting to fintech and market changes are likely to become an examination issue with all the bank regulators.

The Framework is a useful outline for setting expectations and creating regulatory transparency and consistency, which provides goals and actions to support “responsible innovation.” The fintech charter and the new rule on resolutions of nondepository national banks are elements of the Framework. The Framework should help banks in providing services independently and otherwise jointly where nonbank fintech companies are service providers to, or joint venturers with, banks. The OCC’s recognition that all banks need to plan for and consider innovation strategically is important competitively and for the health of the financial services industry. At the same time, fintechs, which need bank relationships or bank powers to efficiently deliver their services, need to know and be able to meet the expectations of the bank regulators, and their bank customers and counterparties, whether with or without a fintech charter.

The Framework and the special-purpose charters envisioned are positive, forward-looking steps with numerous potential benefits to customers, banks, and nonbank providers of financial services, which may be a model for state bank regulators and legislatures. Special purpose charters have in the past, as discussed in our earlier *White Paper*, been delayed and stopped by regulatory and political concerns, including the tension resulting from the historic separation of commercial and banking activities. The Letter from Sens. Sherrod Brown and Jeff Merkley to Comptroller Thomas Curry (Jan. 9, 2017) regarding special-purpose banks is the latest example.

We will continue to closely follow developments in this area, and we are optimistic that the OCC’s actions to foster responsible innovation by banks and nonbanks will benefit customers by better meeting their preferences and needs in faster, more efficient, and cost-effective ways that will benefit the economy.

LAWYER CONTACTS

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ENDNOTES

- 1 See Remarks by Thomas J. Curry, Comptroller of the Currency, Before the Federal Home Loan Bank of Chicago (Aug. 7, 2015).
- 2 *OCC Recommendations and Decisions for Implementing a Responsible Innovation Framework* (Oct. 2016) at p. 2.
- 3 Framework at p.3.
- 4 *Id.* at p.8.
- 5 *Id.* at p.11.
- 6 81 FR 62835 (Sep. 13, 2016).
- 7 81 F.R. 92594 (Dec. 20, 2016).
- 8 See Jones Day Fintech Charter *White Paper*.
- 9 "Fintech Charter Q&A: OCC Answers Skeptics," (Jan. 3, 2017).
- 10 See Jones Day Fintech Charter *White Paper* at p. 3 for a further discussion of these types of agreements.
- 11 See Dodd-Frank Act, Section 314(a).
- 12 12 U.S.C. 222.
- 13 See Section 620 Report, pp. 32-35.

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