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# Special-Purpose National Bank Charters for Fintech Companies

An Overview and Key Considerations

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# Background



- In March 2016, the Office of the Comptroller of the Currency (“OCC”) published a paper titled *“Supporting Responsible Innovation in the Federal Banking System.”*
- On October 26, 2016, the OCC announced the decision to establish an Office of Innovation (“Office”) and implement a framework for responsible innovation.
  - The Office will be headed by a Chief Innovation Officer assigned to OCC Headquarters with staff located in Washington, New York and San Francisco and be the central point of contact and clearing house for requests and information related to innovation.
  - The Office will also implement other aspects of the OCC’s framework for responsible innovation, including
    - establishing an outreach and technical assistance program for banks and nonbanks,
    - conducting awareness and training activities for OCC staff,
    - encouraging coordination and facilitation,
    - establishing an innovation research function, and
    - promoting interagency collaboration.

# Background



- On December 2, 2016, the OCC issued a white paper titled *“Exploring Special Purpose National Bank Charters for Fintech Companies”* and announced that it was accepting special-purpose national bank (“SPNB”) charter applications from fintech companies.
  - Comments on the white paper and thirteen questions were due by January 15, 2017.
  - Last week, Senators Sherrod Brown (D-OH) and Jeffrey Merkley (D-OR) wrote to the Comptroller criticizing the new charter particularly as it concerns financial inclusion efforts, consumer protection laws, and the principle of separation of banking and commerce. The senators also questioned the OCC’s authority to grant the SPNB charter.



Key Features of the

# SPNB CHARTER

- Authority and Activities
- Preemption
- Capital and Liquidity
- Other Federal Regulators
- Other Laws
- Financial Inclusion
- Resolution and Recovery



# SPNB Charter: Authority and Activities



- The OCC has authority under the National Bank Act (“NBA”) to charter national banks, which are legal entities that engage in one or more of the following activities:
  - receiving deposits;
  - paying checks;
  - lending money; or
  - providing fiduciary services.
- An SPNB must provide a subset of the three core banking functions and fiduciary services.
- In addition, an SPNB would be permitted to engage in related activities that are within the business of banking. The OCC and the courts have extensively defined activities that are within the business of banking, such as lease-financing, futures trading and issuing debit cards.
- The OCC has also indicated that, for example, an SPNB established to perform the core banking function of paying checks would also be authorized to provide electronic fund transfer services.

# SPNB Charter: Preemption



- The NBA and its implementing regulations generally provide national banks with the authority to conduct their activities without regard to certain state laws. SPNBs would benefit from the same preemption.
- Examples of **preempted state laws**:
  - Licensing laws, which can relieve some consumer lenders from obtaining one or more licenses in all 50 states.
  - Usury laws, permitting SPNBs to follow the restrictions on interest rates and certain loan-related fees under the laws of the state where the bank is located, even when making loans to borrowers located in other states.
- Examples of state laws that are ***not preempted***:
  - Anti-discrimination (including fair lending) and unfair and deceptive treatment of customers.
  - Rights to collect debts, taxation and zoning, crimes and torts.
- With limited exceptions, the OCC has exclusive authority to exercise visitorial powers (e.g., examination, inspection, regulation and supervision) over national banks.

# SPNB Charter: Capital and Liquidity



- Companies seeking an SPNB charter will propose, for OCC approval, capital levels appropriate for their activities.
  - The varying business activities of companies make it difficult to apply uniform capital standards.
  - The OCC recognizes that the off-balance sheet activities of certain companies may not align well with the generally applicable regulatory capital rules that apply to national banks.
  - The OCC will expect companies to hold capital in excess of the levels that would be required under the regulatory capital rules that generally apply to national banks.
- The OCC will establish tailored liquidity requirements for SPNB charters.
  - The contingent nature of the activities of companies may not be consistent with regulatory expectations for liquidity that apply to national banks.

# SPNB Charter: Other Federal Regulators



- The OCC is the primary regulator of national banks, but other federal banking regulators may have a role to play:
  - Consumer Financial Protection Bureau (“CFPB”)
    - Depending upon its activities, an SPNB could be subject to supervision by both the CFPB and the OCC.
    - The CFPB has supervisory authority over large ***insured*** depository institutions (i.e., those with assets of more than \$10 billion) and certain nonbank financial services companies, including:
      - Residential mortgage lenders and servicers;
      - Private education lenders and payday lenders; and
      - Larger nonbank participants in certain other consumer financial services markets, as defined by CFPB rulemaking.



# SPNB Charter: Other Federal Regulators



- The OCC is the primary regulator of national banks, but other federal banking regulators may have a role to play (cont'd):
  - Federal Reserve
    - National banks are generally required to be members of the Federal Reserve System:
      - Such “member banks,” must subscribe to the stock issued by its relevant Federal Reserve Bank; and
      - They must also comply with regulations issued by the Board of Governors of the Federal Reserve System (“Board”) (e.g., Regulation W’s affiliate transaction restrictions, which are primarily intended to protect insured depository institutions, but apply to all member banks).
    - Full-service national banks are controlled by holding companies that are regulated by the Board as bank holding companies (“BHCs” ):
      - BHCs are subject to extensive regulation that is independent of the regulation of the national bank, including independent capital and liquidity obligations.
      - BHCs and certain nonbank subsidiaries also are separately examined by Board examiners.
      - An SPNB without deposit insurance would not be considered a bank for purposes of the Bank Holding Company Act of 1956.

# SPNB Charter: Other Federal Regulators



- The OCC is the primary regulator of national banks, but other federal banking regulators may have a role to play (cont'd):
  - Federal Deposit Insurance Corporation (“FDIC”)
    - Unless it accepts deposits, an SPNB would not require deposit insurance.
      - This would remove the FDIC from the chartering process.
    - Full-service national banks are required to apply to, and receive approval from, the FDIC for deposit insurance.
      - Until recently, OCC limited-purpose trust companies accepting only trust deposits did not need to have deposit insurance.

# SPNB Charter: Other Laws



- The OCC has announced that there will be a pilot program for fintech companies to test new ideas but no “regulatory sandbox.”
- An SPNB will be subject to the same federal laws and regulations, examination and reporting requirements, and supervision as other national banks, notable examples include:
  - The Bank Secrecy Act, other anti-money laundering laws and economic sanctions administered by OFAC;
  - Prohibitions on engaging in unfair or deceptive acts or practices under Section 5 of the Federal Trade Commission Act, and unfair, deceptive or abusive acts or practices under Section 1036 of the Dodd-Frank Act; and
  - Legal lending limits and restrictions on real estate holdings.
- The OCC can also impose conditions similar to the safety and soundness and records retention provisions of the Federal Deposit Insurance Act (“FDIA”) on an SPNB.

# SPNB Charter: Other Laws



- Some federal laws and regulations will still apply based upon the activities of the company; notably, federal consumer protection laws, including the:
  - Truth in Lending Act;
  - Real Estate Settlement Procedures Act;
  - Home Mortgage Disclosure Act;
  - Equal Credit Opportunity Act,
  - the Fair Credit Reporting Act;
  - Fair Housing Act;
  - Servicemembers Civil Relief Act;
  - Military Lending Act.

# SPNB Charter: Financial Inclusion



- The NBA charges the OCC with ensuring that national banks treat customers fairly and provide fair access to financial services.
  - A company operating under an SPNB charter with deposit insurance will be subject to the Community Reinvestment Act (“CRA”).
  - The OCC applies the principles of fair access and treatment that generally apply to national banks, including uninsured depository institution not subject to CRA.
- The OCC will expect a company engaged in lending to detail in its business plan its commitment to financial inclusion.



# SPNB Charter: Financial Inclusion



- In developing its business plan, a company engaged in lending should specifically:
  - Identify and define its relevant market, customer base or community;
  - Describe the nature of the products or services that it intends to offer, its marketing and outreach plans and the intended delivery mechanisms for its products and services;
  - Explain how such products, services, plans and mechanisms promote financial inclusion; and
  - Provide complete information about how the proposed bank’s policies, procedures and practices are designed to ensure that products and services are offered on a fair and nondiscriminatory basis (e.g., which consumer protections will be included).

# SPNB Charter: Resolution and Recovery



- Resolution Authority
  - Insured banks are resolved by the FDIC under the FDIA.
  - Uninsured national banks are resolved by the OCC under the NBA and the OCC recently finalized its resolution rules.
- The OCC has indicated that it will require companies applying for SPNB charters to provide:
  - A comprehensive framework for how they will remain viable during a period of financial stress; and
  - A clear exit strategy if maintaining its national bank status is no longer viable.

A blurred background image of a business meeting. Several people in professional attire are seated around a table. One person in the foreground is writing in a notebook with a pen. There is a white coffee cup on a saucer, a glass of water, and various papers and pens on the table. The overall atmosphere is professional and focused.

# **APPLICATION, BUSINESS PLAN AND CHARTERING PROCESS**

# Application, Business Plan and Chartering



- A company seeking an SPNB charter will generally follow the same chartering process that applies to all national bank applicants.
- Applicants must include a detailed business plan that thoroughly explains the reason for seeking a charter and engaging in the proposed activities. It should:
  - Cover a minimum of three years and should reflect in-depth preparation by the organizers, the board of directors and management.
  - Demonstrate that the proposed bank has a reasonable chance for success, will operate in a safe and sound manner, and will have adequate capital for its risk profile.

# Application, Business Plan and Chartering



- Specifically, the business plan should:
  - Provide a comprehensive explanation of how the bank will use its resources to achieve its goals and objectives, including how it will measure such efforts;
  - Define the market that the bank plans to serve and the products and services it will provide;
  - Provide realistic forecasts of market demand, economic conditions, competition and proposed customer base;
  - Provide a realistic risk assessment that describes management’s evaluation of the risks inherent in the proposed products and services (e.g., risks related to anti-money laundering requirements, consumer protection, fair lending requirements) and the design of risk management controls and management information systems;
  - Describe the experience and expertise of the proposed management and the board of directors; and
  - A financial inclusion discussion.



# Application, Business Plan and Chartering



1. **Prefiling:** Informal and formal discussions with the OCC take place and the business plan is developed.
2. **Filing:** Organizers submit a formal application for a charter.
3. **Review and evaluation:** The OCC conducts background and field investigations to determine whether the applicant:
  - Has a reasonable chance of success;
  - Will be operated in a safe and sound manner;
  - Will provide fair access to financial services;
  - Will ensure compliance with applicable laws and regulations;
  - Will promote fair treatment of customers; and
  - Will foster “healthy” competition.
4. **Final approval:** The OCC determines that the applicant has met the requirements and conditions to operate under a federal charter.
  - This stage includes the granting of “preliminary conditional approval,” whereby a number of standard requirements are imposed (e.g., the establishment of appropriate policies and procedures, adoption of an internal audit system).
  - Additional conditions are often imposed in connection with a new bank charter, including that the newly chartered bank not deviate from its business plan without prior approval/non-objection from the OCC.
  - The OCC could also impose specific capital and liquidity requirements and require the submission of a resolution plan.



# **POINTS TO CONSIDER IN EVALUATING THE SPNB CHARTER**

# Points to Consider in Evaluating the SPNB Charter



- 1. Whether the company is eligible and its activities are permissible for a national bank.**
  - The OCC has not provided any significant guidance regarding the scope of what is a “fintech company” or if it specifically excludes any types of businesses (beyond payday lenders).
  - With respect to permissible activities, lending and payment businesses would almost certainly qualify.
  - Other types of companies, however, may require a more detailed analysis and discussion with the OCC before submitting an application.

# Points to Consider in Evaluating the SPNB Charter



## 2. Additional banking laws and regulations that will apply to the company's business.

- Company focused on lending will need to consider lending limits, credit classification standards and loan loss reserves.
- To ensure competitive equality, safety and soundness, or the needs of the public, the OCC could require compliance with those laws generally applicable to insured depository institutions even if the company does not intend to seek deposit insurance (e.g., CRA-type obligation).
- Restrictions or prior approvals on any transfer of ownership or new investors with controlling interest.
- The OCC could also require the parent of an SPNB to provide financial support through a Capital Assurance and Liquidity Maintenance Agreement or similar agreement.

# Points to Consider in Evaluating the SPNB Charter



- 3. Potential impact of OCC's supervision and examination of the policies, procedures and compliance management system on the company's business.**
  - OCC examinations are extensive and will require a significant amount of preparation and follow-up by employees of the SPNB.
  - An SPNB and its institution-affiliated parties could face informal, formal, or public enforcement actions as a result of the supervision and examination process.
  - In addition to significant monetary penalties, the OCC could require the bank to terminate certain activities, refrain from new activities, replace management or raise additional capital.



# Points to Consider in Evaluating the SPNB Charter



## 4. Impact of comprehensive safety and soundness regulation on the operating of the company's business.

- Although the OCC has suggested that it might tailor its supervision of an SPNB charter to some degree, the heightened level of oversight may effectively restrict or limit the operation of the business.
- New restrictions may impair innovation and limit a company's ability to compete with nonbank institutions.
  - A company operating under an SPNB charter may need prior approval/non-objection from the OCC to deviate from its three-year business plan, create new subsidiaries, pay dividends or invest in other companies.
  - OCC approvals related to transfers of ownership or new shareholders may limit exit strategy or ability to raise capital.

# Points to Consider in Evaluating the SPNB Charter



## 5. Impact of SPNB Charter on the existing structure of company's business.

- Activities transferred to the SPNB.
- Location of the SPNB and ability to conduct certain activities from main office (especially if exporting rates and fees of bank's home state).
- Restrictions on transactions between SPNB and its affiliates under Section 23A/B and Regulation W.
- Affiliates providing services to SPNB would be subject to supervision by the OCC.
- Regulation of physical locations of the SPNB other than the main office (e.g., branches or loan production offices).

# Key Takeaways



- The announcement of the SPNB charter is an overall positive development for financial services companies.
  - Companies will need to consider the advantages and disadvantages of the charter.
  - Engaging with the OCC may help determine whether this charter is a good fit for a particular organization.
- The SPNB charter might be appropriate for some companies, particularly those burdened with conflicting 50-state compliance obligations or ineligibility issues (e.g., licensing, interest rate exportation and payment systems access).
- Other companies may not find the charter to be a good fit, particularly in light of capital, liquidity and source of funding issues.
- Applying for an SPNB charter should be a particularly viable option for companies that are well-capitalized, have a strong management team and demonstrated success of business model.

# Key Takeaways



- Additional information from OCC still needed:
  - Capital requirements
  - Liquidity requirements
  - OCC assessment fees
  - Financial inclusion obligation
- Additional information needed from other regulators and associations regarding the authority and treatment of an SPNB (e.g., FRB discount window, payment systems access and FHLB membership).

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