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So You Think You Want a Bank Charter?

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Overview of Today's Briefing



- Bank Charter Overview
- OCC's Special Purpose National Bank Charter
- Industrial Loan Companies
- Other Limited Purpose Banks and Full-Service Banks
- Bank Holding Company Regulation
- Overview of Application and Chartering Process

Bank Charter Overview



- Dual banking system in the United States: federal and state chartered banks.
- Regardless of the charter, banking is a highly regulated business and banks are subject to examination and supervision by their regulators and prudential overregulation (e.g., safety and soundness).
- Within the federal and state banking charters, there are limited purpose and full-service charters.
- Today, we will discuss a few of the different chartering options.

SPNB Charter: Background



- On July 31, 2018, the OCC announced that it would begin accepting applications for SPNB charters.
- Accompanying the announcement were a Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters and a related supplement to the OCC's Licensing Manual.
- Potential applicants have been meeting with the Office of Innovation to discuss the charter and the OCC's expectations.
- OCC has publicly indicated that it does not expect any approvals until next year.

SPNB Charter: Litigation



- New York State Department of Financial Services (NYDFS) and the Conference of State Bank Supervisors (CSBS) filed lawsuits to block the OCC's ability to issue SPNB charters to fintech companies.
- These lawsuits were dismissed in December 2017 and April 2018 on the basis that the claims were not ripe as the OCC had not yet decided whether to accept applications or issue any charters.
- On September 14, 2018, the NYDFS filed a lawsuit (again) alleging the OCC does not have the legal authority to issue SPNB charters.

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.

SPNB Charter: Authority and Activities



- 12 U.S.C. § 85 permits a national bank to charge “interest” at the rate permitted by the laws of the state where the bank is located.
- “Interest” encompasses all charges that compensate the creditor for the extension of credit or the borrower’s default.
 - Periodic finance charges
 - Late fees
 - Membership fees or annual fees
 - Overlimit fees
 - NSF fees
 - Prepayment fees

SPNB Charter: Authority and Activities



- 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.

SPNB Charter: Regulatory Expectations, Capital, Liquidity and Contingency Planning



- The OCC had indicated that that companies receiving the SPNB charter will be subject to the same high safety and soundness standards that all federally chartered banks must meet.
- The OCC will tailor these standards to reflect the SPNB's size, complexity and risk profile, but the SPNB charter is not a “regulatory-lite” option.
- Companies seeking an SPNB charter will propose, for OCC approval, capital levels appropriate for their activities.
- The OCC will establish tailored liquidity requirements for SPNB charters but expects companies to develop a contingency plan to address significant financial stress that could threaten the viability of the institution.

SPNB Charter: Role of Other Regulators



- CFPB has supervisory authority over large ***insured*** depository institutions (i.e., those with assets of more than \$10 billion).
- National banks are generally required to be members of the Federal Reserve System (e.g., purchase the stock issued by its relevant Federal Reserve Bank in amount equal to six percent of its combined capital and surplus).
- Full-service national banks are controlled by holding companies that are regulated by the Board as bank holding companies (“BHCs”).
- Unless it accepts deposits, an SPNB would not require deposit insurance from FDIC.

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 would not be subject to the Community Reinvestment Act (“CRA”) but would need to have a plan for financial inclusion.
 - 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 applicants to detail in its business plan its commitment to financial inclusion.

Open Issues



- Access to the payment system
- Access to the Federal Reserve Board's discount window
- Federal home loan bank membership

Industrial Loan Companies



- What is an Industrial loan company (“ILC”)
 - State corporation with banking powers
 - Chartered under state law
 - Primarily located in Nevada or Utah
 - Utah has longer history and more entities
 - Nevada offers state thrift charter which is similar
 - Has FDIC insurance and accepts certain types of deposits (i.e., time deposits)

Industrial Loan Companies – Permissible Activities



- Full range of loans products
 - Consumer or commercial
 - Unsecured or secured
 - Revolving or closed-end
- Deposit products (excluding demand deposits)
 - Certificates of deposits
 - Brokered certificates of deposits
- Structured finance activities (securitization)

Industrial Loan Companies - Benefits



- Exportation of rates and fees for direct loans
 - Nationwide lending program
 - Uniform interest rates and fees
 - Utah and Nevada rates and fees are largely deregulated
 - More potential borrowers due to risk-based pricing
- Generally no state licenses for lending needed by ILC
 - No federal preemption
 - States generally exclude insured depository institutions
- Parent not bank holding company, so no FRB supervision of parent or consolidated capital requirements

Industrial Loan Companies - Burdens



- Capital and liquidity requirements
- Deposit insurance premiums
- Community Reinvestment Act (CRA)
- Examination
- Compliance
- Volcker Rule

Industrial Loan Companies - Burdens



- Regulatory environment has been difficult
 - Various legislative and regulatory moratorium over the past 15 years have limited new charters and the transfer of existing charters.
 - No recent applications for deposit insurance have been granted by the FDIC in connection with ILC charters.
 - Three recent applicants have withdrawn their applications with stated intention of refileing at a later date.

Other Limited and Full-Service Bank Charters



- Credit Card Banks
 - State and federal charters are available
 - Limit on type of lending and deposit-taking activities
- Trust Companies
 - State and federal charters are available
 - Primarily limited to fiduciary activities
- FDIC-Insured National Banks and State-Chartered Banks
 - Full range of lending and deposit-taking activities
 - Parent regulated as a bank holding company

Bank Holding Company Regulation



- What makes alternative charters so attractive for some organizations if the chartered entity (SPNB, ILC, etc.) is subject to “bank-like” regulation?
- Alternative charters generally avoid exposing the rest of the corporate group—i.e., holding company and nonbank affiliates—to the same degree of regulation as would result from a full service bank charter.
- Focus today will be the Bank Holding Company Act of 1956 (i.e., organizations with a national or state “bank” subsidiary), but similar regulatory impact for organizations with a “savings association” or “thrift” subsidiary.

Bank Holding Company Regulation



- What is a bank holding company?
 - Any company that directly or indirectly (i.e., through a subsidiary) “controls” a bank.
 - Bank holding company status attaches equally to an acquirer of an existing bank or a company that forms a *de novo* bank subsidiary.
 - Only applies to “companies” (i.e., not individuals), but company defined broadly to include virtually any form of legal entity; in some cases a legal entity is not required (e.g., “association” of natural persons).
 - Becoming a bank holding company requires application to and prior approval of Federal Reserve.

Bank Holding Company Regulation

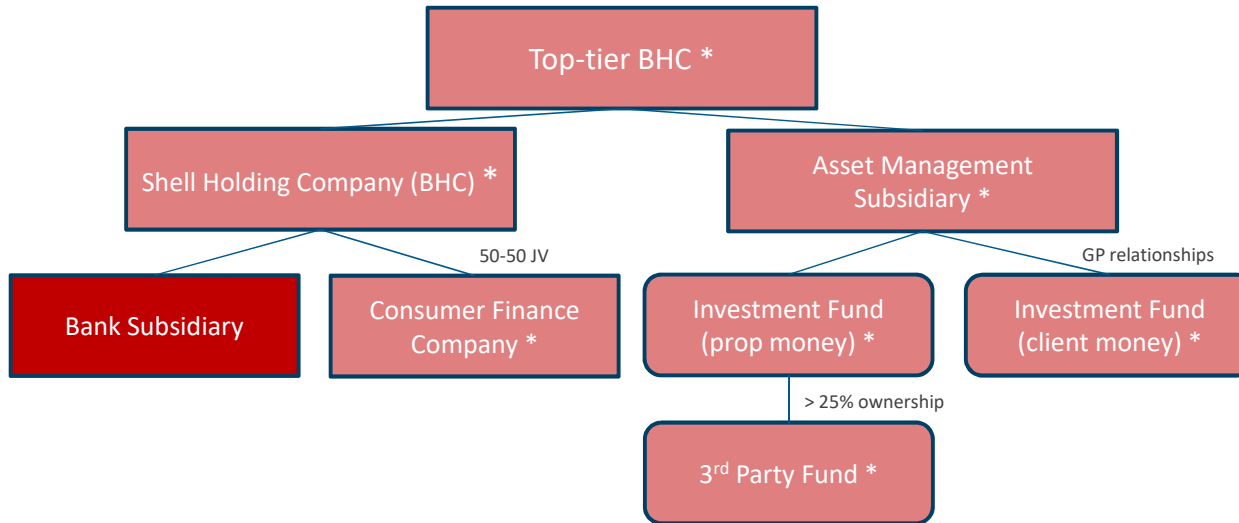


- BHCA definition of control, which determines entities subject to the Act, is expansive
 - Own, control, or power to vote 25% or more of any “class” of “voting securities” of a company
 - Control in any manner over the election of a majority of the directors, trustees, general partners (or similar) of a company
 - Exercise a “controlling influence” over the management or policies of a company; fact-specific analysis based on extensive Fed guidance
 - Own or control 25% or more of total equity (up to 33.3% in some cases)
 - Factors include ownership of securities, representation on board, director/management interlocks, veto/consent rights, material business relationships

Bank Holding Company Regulation



- Representative BHCA “control group”



* Entities subject to nonbanking activities restrictions of the BHCA

Bank Holding Company Regulation



- Impact of the BHCA – Activities Restrictions
- Under Section 4 of the BHCA, the BHC and all nonbank subsidiaries are prohibited from engaging in or acquiring shares of a company engaged in any activity other than banking, except pursuant to a specific exemption.
 - 4(c)(6) – Up to 5% voting/24.9% non-voting in any company (otherwise passive)
 - 4(c)(7) – Investments in funds that only make sub-5% investments in portfolio companies
 - 4(c)(4) – Fiduciary holdings on behalf of clients

Bank Holding Company Regulation



- Impact of the BHCA – Activities Restrictions (cont’d)
- Section 4(c)(8) permits activities deemed “closely related to banking”
 - Extending credit and servicing loans
 - Activities related to extending credit (e.g., real estate appraisal; collection agency services; asset management, servicing and collection; acquiring debt in default)
 - Leasing real or personal property
 - Financial and investment advisory services
 - Certain agency and principal investment transactions
 - Data processing (vehicle for certain fintech investments)

Bank Holding Company Regulation



- Impact of the BHCA – Activities Restrictions (cont’d)
- Section 4(k) permits broader range of “financial activities” for BHCs that have made a special election to obtain “financial holding company” or “FHC” status.
 - Insurance underwriting
 - Full-service brokerage and other securities activities
 - Merchant banking investments
- Other commercial activities still generally prohibited (e.g., real estate management/development).

Bank Holding Company Regulation



- Impact of the BHCA – Volcker Rule
 - After Dodd-Frank, BHCs and all subsidiaries broadly prohibited from “proprietary trading” and investing in or having certain relationships with “covered funds”,
 - Short-term trading of securities, derivatives, and other financial instruments for the BHC’s (or subsidiary’s) own account.
 - Acquiring a proprietary (own account) ownership interest in most private equity, venture capital, or hedge fund (many other private collective investment vehicles).
 - Customer-driven activities not involving balance sheet position-taking generally OK, subject to extensive compliance obligations.

Bank Holding Company Regulation



- Impact of the BHCA – Source of Strength, Capital, Liquidity, and Other Prudential Regulation
 - BHC required to serve as source of financial strength and support for its bank subsidiary; Fed supervisory interest in monitoring ability to meet that obligation.
 - Depending on size, nature of activities, risk profile, and other factors, BHCs subject to varying levels of minimum capital and liquidity requirements and other related standards.
 - Increasingly, most significant impacts being tailored so as to apply only (or primarily) only to largest and most sophisticated BHCs, but requirements remain (e.g., Basel III capital framework).
 - Capital and liquidity stress testing, risk management requirements.

Bank Holding Company Regulation



- Impact of the BHCA – Federal Reserve Supervision and Oversight
 - For many new BHCs, “cultural” impact of being regulated by the Fed is among most difficult challenges.
 - Extensive substantive regulation and compliance obligations (e.g., BSA/AML, consumer, vendor management, cyber).
 - BHC and all nonbank subsidiaries subject to the Fed’s supervisory and examination authority.
 - Reporting obligations for all activities, acquisitions, etc.
 - Lapses in BHCA compliance can lead to extensive engagements with Fed staff, formal and informal enforcement actions.

Bank Holding Company Regulation



- When does a full-service bank (or thrift) charter potentially make sense for the broader organization?
 - Business model that would benefit from ability to accept insured deposits (or other aspect of full-service charter)
 - Organization is limited to permissible nonbanking activities
 - No extensive proprietary (“own account”) trading activities or private fund investments
 - Institutional ability to contend with extensive regulatory compliance obligations and extensive Fed oversight
 - Management with significant banking experience

Bank Holding Company Regulation



- Regulatory framework for “small bank holding companies” (variously defined) less burdensome and potentially more feasible for certain organizations.
- **Volcker Exclusion:** Top-tier BHCs with \$10B or less in total consolidated assets and minimal trading assets and trading liabilities.
- **Basel III Exclusion:** Top-tier BHCs with less than \$3B in assets, no “significant” nonbanking activities, and no material off-balance sheet activities (e.g., securitization).
- **Pending Capital Simplification Rulemaking:** Top-tier BHCs if the BHC has total consolidated assets of less than \$10B.
- **Reduced and Streamlined Examination Process:** Top-tier BHCs with total consolidated assets of \$10B or less.
- **Proposed Swap Clearing Exemption:** BHCs with aggregate assets of \$10B or less.

Application, Business Plan and Chartering



- The business plan would typically cover a minimum of three years of operation and should:
 - Provide a comprehensive explanation of how the bank will use its resources to achieve its goals and objectives
 - Define the market 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 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.

Application, Business Plan and Chartering



- A company seeking a bank charter (whether chartering a new or acquiring an existing institutions) will generally follow a detailed application process.
 - **Prefiling:** Informal and formal discussions with the OCC take place and the business plan is developed.
 - **Filing:** Organizers submit a formal application for a charter.
 - **Review and evaluation:** The OCC conducts background and field investigations to determine whether the applicant has a reasonable chance of success and, amongst other things, will operate in a safe and sound manner and comply with applicable laws and regulations.
 - **Final approval:** The OCC determines that the applicant has met the requirements and conditions to operate under a federal charter.

Key Points for Companies to Consider



1. Whether the company is eligible and its activities are permissible for a bank.
2. Potential impact of banking agency supervision and examination of the policies, procedures and compliance management system on the company's business.
3. Impact of comprehensive safety and soundness regulation on the operating of the company's business.
4. Impact of bank charter on the existing structure of company's business.
5. What are the costs of operating the bank and the potential savings over current business model.

QUESTIONS?



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