

SDNY Blocks OCC's Fintech Charter: Considerations for Fintech Companies

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Fintech companies seeking to offer consumer financial products and services in the United States often must go through the time-consuming, costly process of obtaining a license in each state in which they intend to operate. In an effort to promote efficiency and reduce regulatory complexity, the Office of the Comptroller of the Currency ("OCC") proposed to issue a special-purpose national bank charter ("Fintech Charter") to nondepository fintechs wishing to conduct regulated banking activities on a national scale.

The Fintech Charter has been challenged in court by the New York Department of Financial Services ("DFS") that considers the OCC's initiative as infringing on its jurisdiction. On May 2, 2019, Judge Marrero from the Southern District of New York ("SDNY") denied the OCC's motion to dismiss the DFS lawsuit, thereby casting a cloud over the viability of the Fintech Charter. On October 21, 2019, the SDNY entered a final judgment against the OCC preventing the agency from chartering any fintech applicants, paving the way for an appeal to the Second Circuit. Whether the Second Circuit will come to a different conclusion remains unclear.¹

Background

The OCC first began considering whether to offer a Fintech Charter to non-depository fintech companies in 2016. The OCC formally unveiled a proposal to create the Fintech Charter later that year in an effort to bring innovative financial firms under regulation while promoting financial inclusion and responsible innovation. The OCC's initiative was met with immediate scrutiny and resistance from state regulators. In April 2017, the Conference of State Bank Supervisors ("CSBS") filed a lawsuit in the DC District Court to contest the OCC's statutory authority to charter fintech companies. The DFS filed a similar action in the SDNY shortly thereafter. According to the two lawsuits, allowing the OCC to proceed would deprive state residents from the critical financial protections afforded by state banking law and oversight.

Both the DFS and the CSBS actions were dismissed without prejudice in December 2017 and April 2018, respectively. The courts determined that, because the OCC had yet to receive or review any Fintech Charter applications, the agencies' claims were too speculative and not yet ripe for adjudication.

The Current Litigation

On July 31, 2018, the OCC announced that it would begin to accept and review Fintech Charter applications. In September and October 2018, CSBS and DFS renewed their challenges to the OCC's authority to charter

¹ The case is *Linda A. Lacey v. Office of the Comptroller of the Currency, et al.*, No. 2018-cv-08377 (S.D.N.Y. Sept. 14, 2018).

fintech companies. The OCC moved to dismiss both actions in early 2019, arguing that the claims were still premature because no applications had been approved. On September 3, 2019, Judge Friedrich in the DC District Court sided with the OCC and dismissed the CSBS lawsuit for the second time without prejudice. By contrast, SDNY Judge Marrero’s May 2, 2019 decision to deny the OCC’s motion cast a cloud over potential Fintech Charter applications.

The SDNY found that the DFS’s claims were ripe for adjudication as the OCC’s July 2018 announcement reflected the OCC’s “clear expectation” to issue Fintech Charters. The court was also unpersuaded by the OCC’s argument that it has authority under the National Bank Act (“NBA”) to issue Fintech Charters. Specifically, the NBA gives the OCC the statutory authority to grant national bank charters to companies engaged in the “business of banking.” The court found that the term “business of banking” as used in the NBA unambiguously requires charter applicants to receive deposits as an aspect of their business. The court further noted that Congress had given the OCC limited authority to charter only three specific types of national banks that do not accept deposits—namely banker’s banks, credit card banks, and trust banks.

Following Judge Marrero’s decision to deny dismissal of the lawsuit, the OCC and the DFS entered into negotiations to reach a final judgment in the DFS’s favor. The two sides, however, failed to reach an understanding on the geographic scope of the court’s relief. While the OCC argued that a final judgment should only preclude companies with a nexus to New York State, the DFS pushed for broader language to bar any company from seeking a Fintech Charter. On October 21, 2019, Judge Marrero sided with the DFS’s proposed language and reiterated that the NBA requires that only firms taking deposits may receive a national bank charter from the OCC. The OCC is expected to appeal the decision to the Second Circuit. While it is unclear whether the Second Circuit will come to a different conclusion, the OCC’s authority to grant Fintech Charters continues to remain subject to renewed challenge by CSBS once a charter is eventually issued.

Litigation Overview: Timeline	
December 2, 2016	<ul style="list-style-type: none"> OCC publishes fintech whitepaper exploring the potential for a Fintech Charter
March 15, 2017	<ul style="list-style-type: none"> OCC publishes draft licensing procedures describing application requirements for a Fintech Charter
April – May 2017	<ul style="list-style-type: none"> DFS and CSBS file separate lawsuits challenging the OCC’s authority to grant Fintech Charters
December 2017 – April 2018	<ul style="list-style-type: none"> SDNY and DC District Court respectively dismiss each lawsuit without prejudice
July 31, 2018	<ul style="list-style-type: none"> OCC announces it will start accepting Fintech Charter applications
September – October 2018	<ul style="list-style-type: none"> DFS and CSBS renew their challenges in SDNY and DC District Court
May 2, 2019	<ul style="list-style-type: none"> SDNY denies the OCC’s motion to dismiss the DFS lawsuit
September 3, 2019	<ul style="list-style-type: none"> DC District Court dismisses CSBS’s second lawsuit without prejudice
October 21, 2019	<ul style="list-style-type: none"> SDNY enters final judgement in DFS’s favor, precluding <i>any</i> company from applying for a Fintech Charter

Alternative Options for Fintechs

As the New York and DC cases play out, fintechs may wish to consider alternative options to access the US banking system. Pending litigation is not the only concern for potential Fintech Charter applicants. The cost of the supervisory burden, including capital, liquidity, financial inclusion and risk management requirements resulting from the OCC chartering process, dilute the appeal of the Fintech Charter – the benefits of which remain largely unknown and untested. It further remains unclear whether the Fintech Charter would allow companies to participate directly in FedWire and other services of the current Federal Reserve’s payment system—an important point that the Federal Reserve has yet to clarify. Absent positive clarification, companies also would likely not have access to the Federal Reserve’s proposed FedNow real-time payments service, which, in its current form, is limited to depository participants.

Moving forward, fintechs seeking to engage in regulated activities should evaluate the costs and benefits of alternative federal charter types. Notably, a full-scale OCC national bank charter has become an attractive option for an increasing number of fintechs. While this option subjects applicants to some of the costly regulatory requirements that make the Fintech Charter unappealing, it also eliminates many of the uncertainties fintech firms would face and allows for expansive full banking powers. To date, the OCC has granted preliminary approval to one mobile-only banking platform and is currently reviewing an application submitted in April 2019 by an online stock trading platform.

Another option for fintechs to consider is the industrial loan company (“ILC”) federal charter, which has received renewed interest in recent years. The Federal Deposit Insurance Corporation (“FDIC”), which oversees ILCs, had long been reticent to grant deposit insurance to ILC applicants and has not approved an ILC application since 2008. The leadership change at the FDIC, however, may pave the way to a possible wave of new ILC charters. An established payment platform and an online bank and credit card company currently have ILC applications pending before the FDIC.

Beyond federal and state chartering or licensing options, fintechs focused on payments and/or lending activities may avoid state-by-state licensing requirements by entering into partnerships with existing banks. Bank partnerships, when properly and strategically structured, offer a number of competitive advantages and present a successful model for many fintech firms.

Chartering/Licensing Options for Fintech Companies

	OCC Fintech Charter	National Bank Charter	ILC	State Bank Charter	Bank Partnership Model	Multistate Licensing
Primary Banking Regulator(s)	OCC	OCC	FDIC / State	State / FDIC or Federal Reserve	–	State
Pros	<ul style="list-style-type: none"> ○ Federal preemption ○ Banking powers (except deposit-taking activities) ○ Regulatory requirements may be tailored ○ Primary oversight by a single regulator 	<ul style="list-style-type: none"> ○ Federal preemption ○ Full-service banking powers ○ Automatically a member of the Federal Reserve System (“FRS”) ○ FDIC insurance ○ Primary oversight by a single regulator ○ OCC approval already granted to a fintech company 	<ul style="list-style-type: none"> ○ Federal preemption ○ Full-service banking powers for ILCs with total assets under US\$100 million ○ FDIC insurance ○ No bank holding company treatment for parent company 	<ul style="list-style-type: none"> ○ Federal preemption ○ Full-service banking powers ○ Eligible for FDIC insurance ○ Eligible to become an FRS member ○ Certain state bank charters may provide more powers than a federal charter (e.g., trust powers) ○ Certain states allow for an uninsured bank charter not subject to FDIC approval 	<ul style="list-style-type: none"> ○ No direct oversight by federal banking regulator(s) ○ Flexibility in tailoring the partnership to meet commercial objectives ○ Increased openness of banks to act as partners ○ May export interest rates 	<ul style="list-style-type: none"> ○ Licensing tailored to activities (e.g., consumer or commercial lending, money transmission) ○ Less onerous approval requirements and compliance obligations ○ Current multistate efforts to combine licensing/examinations among the 50 states
Cons	<ul style="list-style-type: none"> ○ Bank-like approval requirements and compliance obligations ○ Uncertainty pending resolution of DFS and CSBS lawsuits ○ Uncertainty regarding access to the Federal Reserve’s payments system ○ Holding company status for parent company 	<ul style="list-style-type: none"> ○ Onerous approval requirements and compliance obligations ○ Anti-tying and affiliate transactions restrictions ○ Bank holding company treatment for parent company ○ Uncertainty regarding FDIC approval for deposit insurance 	<ul style="list-style-type: none"> ○ Bank-like approval requirements and compliance obligations ○ Dual application with, and oversight by, the FDIC and the relevant state banking agency ○ Anti-tying and affiliate transactions restrictions ○ May be subject to written agreements imposing additional constraints on ILC and/or parent ○ Uncertainty regarding FDIC approval ○ ILC charter authorized to date only in a limited number of states 	<ul style="list-style-type: none"> ○ Dual oversight by the relevant state banking agency and the FDIC (if FDIC-insured) or Federal Reserve (if member of the FRS) ○ Federal law requirements still apply (capital adequacy, AML, restrictions on anti-tying and affiliate transactions, consumer protections) ○ Bank holding company treatment for parent company ○ Uninsured bank charter available in certain states preclude deposit-taking activities; lack of clarity regarding access to the Federal Reserve’s payments system 	<ul style="list-style-type: none"> ○ Uncertainty regarding interest rate exportation for certain partnership models following <i>Madden</i> ○ Indirect oversight by federal banking regulator(s) as an Institution Affiliated Party or as a service provider through the Bank Services Company Act ○ Bank partner may impose onerous audit rights on fintech partners 	<ul style="list-style-type: none"> ○ No federal preemption ○ Powers limited to license type ○ No direct access to FRS payment systems ○ Multistate licensing /examination efforts currently limited to money transmission ○ Subject to oversight by multiple state regulators

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