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The OCC and FinTech—Ready for Innovation and Collaboration

In a long-awaited decision, on July 31, 2018, the Office of the Comptroller of the Currency announced that it will move ahead with accepting applications for national bank charters from nondepository FinTech companies. While this is a direct game changer for FinTech stakeholders, the impact of this determination will be felt throughout the financial services industry at-large.

INTRODUCTION

Last week, the Office of the Comptroller of the Currency (“OCC”) announced that it will begin accepting applications for national bank charters from nondepository financial technology (“FinTech”) companies engaged in the business of banking. As defined in the OCC’s regulations, the “business of banking” includes any of the three core banking functions of (1) receiving deposits, (2) paying checks, or (3) lending money. Thus, the OCC has authority to grant a national bank charter to a FinTech company that engages in one or more of those core banking activities. Still, there have been many challenges brought by states (*most prominently, by the New York State Department of Financial Services*) against the prospect of OCC nondepository FinTech charters, leading to almost two years of legal limbo, effectively slowing down changing markets that are coming up against decades-old regulatory approaches and models.

In recent years, we have all seen a surge of technology-driven innovation in financial markets and services. And even though the tangible physics of *Moore’s Law* may no longer be on the originally anticipated chronological track, it is axiomatic that necessity is the mother of invention, and these inventions should be explored rather than automatically burdened. Along these lines, it should be noted, that the OCC adopted this new policy after careful consideration of the extensive stakeholder feedback and public comment received over the past two years. As stated by Comptroller of the Currency Joseph M. Otting:

“The decision to consider applications for special purpose national bank charters from innovative companies helps provide more choices to consumers and businesses, and creates greater opportunity for companies that want to provide banking services in America. Companies that provide banking services in innovative ways deserve the opportunity to pursue that business on a national scale as a federally chartered, regulated bank.”

FINTECH LENDING MODELS

Prior to the announcement by the OCC, domestic FinTech lenders generally had five (*less than optimal*) options in the structuring of their lending business. Under the *first*, commonly referred to as the “Direct Lending Model,” the lender makes loans directly to the borrower. Here, the most significant issue is directing lending activities on a state-by-state basis, requiring a lender to tailor its activities and documentation to each jurisdiction, significantly increasing costs. This is highly burdensome, as the state regulatory environment is a complex maze of guidelines and administrative bodies that are overlapping, where compliance with each regulation is essential, and compliance with one regulation/interpretation does not necessarily constitute compliance with any others, even where the subject matter is overlapping. Against this backdrop of inconsistent and ambiguous rules based solely on anecdotes, the Direct Lending Model has high barriers to entry, and the possibility of stunted innovation in the name of traditional gatekeepers clamouring for the status quo.

The *second*, referred to as the “Affiliate Model,” involves a strategic relationship with a state-chartered bank or a nationally-chartered credit card bank, via a series of contractual arrangements. Utilizing the Affiliate Model could obviate the need to be licensed as a direct lender in each state in which the FinTech company has borrowers. However, many states also require licenses for “brokers” or “servicers” of consumer loans. Each state that requires such a license has its own regulatory structure, requirements for licensure, and uses different terms, definitions, and exemptions. What’s more, in order to truly benefit from the federal rights of exportability and preemption, the FinTech company may have to demonstrate that the bank is actually the true lender *by using a predominant economic interest test*, which views the substance, rather than the form, of the loan transactions.

The *third*, referred to as the “Native American Affiliation Model” involves a strategic relationship with a Native American tribe that is statutorily immune from state taxes and laws regarding usury. Although this once seemed

like a viable and much simpler alternative than affiliating with a chartered bank, due to regulatory decision and lawsuits, this model is a complete non-starter.

The *fourth* option involves chartering what’s known as a “credit card bank” through the OCC. There are many benefits of owning and operating a nationally chartered credit card bank, however, in light of the high barrier to entry, time, expense, and effort of the application process, as well as the OCC’s continuing standstill in granting new charters, this is most likely limited to a theoretical option at this time.

The *fifth* option, the Industrial Loan Charter (“ILC”), has seen a lot of activity and discussion in the FinTech world, with two major industry players attempting to secure an ILC. However, similar to the fourth option, many states and outside groups are pushing for a complete moratorium on any and all such applications. Indeed, the Federal Deposit Insurance Corporation last approved insurance for an ILC back in 2008.

NATIONAL BANK CHARTERS FOR NONDEPOSITORY FINTECH COMPANIES

As of July 31, 2018, FinTech companies now have a new option that has been coordinated, vetted, and instituted by the OCC. FinTech companies now have an opportunity for an even playing field in crafting modern systems and solutions to creating better products and sustainable services to consumers and the marketplace. Some of the benefits of FinTech innovation include decreasing transaction costs, global financial inclusion, and increased opportunity for lending spaces increasingly vacated by traditional servicers. Unquestionably, this convergence of FinTech and banking raises important questions and challenges for regulators. However, these challenges could lead to a fundamental shift in using measurable/ data driven decision making, leading to rational, dynamic, and quantifiable regulations.

Regarding the process, the OCC will use its existing chartering standards and procedures for processing applications from FinTech companies as outlined in the *Comptroller’s Licensing Manual*. As with all national

banks, the OCC will consider whether a proposed bank has a reasonable chance of success, will be operated in a safe and sound manner, will provide fair access to financial services, will treat customers fairly, and will comply with applicable laws and regulations. The OCC will also consider whether the proposed bank can reasonably be expected to achieve and maintain profitability and whether approving the charter will foster healthy competition. Though it should be noted, the OCC will not approve proposals that would result in an inappropriate commingling of banking and commerce.

CONCLUSION

Applying the framework of a national bank charter to qualified FinTech companies can provide uniform standards and robust supervision, thereby ensuring that they operate in a safe and sound manner, fairly serving the needs of consumers, businesses, and communities. More broadly, this should provide consistency in the application of laws and regulations, while strengthening economic growth and the federal banking system.

Blank Rome attorneys are available to assist with any questions you may have regarding the OCC's recent announcement. To that end, we work with FinTech companies in overcoming the challenges of competing in the global economy. Likewise, we have many attorneys across multiple practice groups active in obtaining de novo bank charters, as well as experience representing banks on a wide range of matters in the complex regulatory environment in which they operate.

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