

# Client Alert

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## OCC Releases Draft Supplement and Response to Comments for Special Purpose National Bank Charter for Fintech Companies

By **Obrea O. Poindexter, Oliver Ireland, Sean Ruff, and Crystal Kaldjob**

On March 15, 2017, the Office of the Comptroller of the Currency (“OCC”) released a Draft Supplement (“Draft Supplement”) to its existing licensing manual laying out its framework for evaluating Fintech companies that apply for a special purpose national bank charter. In conjunction with the release of the Draft Supplement, the OCC released its Summary of Comments and Explanatory Statement (“Summary of Comments”), in which the OCC responded to criticisms of its charter initiative. Significantly, the OCC stated that, for purposes of the Draft Supplement, a “special purpose national bank” is limited to a national bank that engages in a limited range of banking activities (including at least one of the core banking functions) but does *not* take deposits and is not insured by the Federal Deposit Insurance Corporation. The limited non-deposit-taking feature of the Fintech charter does not prevent Fintech companies that want to take deposit from applying for a traditional national bank charter.

The Draft Supplement and Summary of Comments come at a time of heightened focus on the OCC’s plans to grant special purpose national bank charters to Fintech companies. Just recently, several House Republicans, including House Financial Services Committee Chairman Jeb Hensarling, reportedly sent a letter to Comptroller Thomas Curry expressing concern that the OCC was proceeding with granting the charter “without providing the details of the charter or an opportunity for comment” and urging the Comptroller to delay the charter initiative so that the incoming Comptroller of the Currency is given an “opportunity to assess” the initiative. State regulators, including the Conference of State Bank Supervisors (“CSBS”) and the New York Department of Financial Services, have voiced their concerns about the OCC’s charter initiative, both as comments to the OCC’s proposal and in public announcements.

### DRAFT SUPPLEMENT

The OCC noted that there are three “threshold principles” that will guide the OCC in granting special purpose national bank charters and that informed the Draft Supplement: (1) that the OCC would not allow “inappropriate commingling of banking and commerce,” (2) that the OCC would not allow products with predatory features or allow unfair or deceptive acts or practices and (3) there would be no “light-touch” supervision of special purpose national banks.

The Draft Supplement sets out the application process, including pre-filing communications with the OCC, and the OCC’s chartering standards. The Draft Supplement suggests that Fintech companies applying for a special purpose national bank charter will be subject to bank-like requirements, including requirements related to business structure, risk management controls and CAMELs ratings based on capital levels, asset quality and other factors. The Draft Supplement also includes details on the OCC’s expectations with respect to meeting the financial inclusion obligations. Comments on the Draft Supplement are due April 14, 2017.

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## SUMMARY AND RESPONSE TO COMMENTS

In the Summary of Comments, the OCC responded to the more than 100 comment letters on its charter initiative and outlined the benefits of a special purpose national bank charter, including promoting consistency in the application of federal laws; strengthening the financial system by promoting growth, modernization and competition and broadening access to financial services. Particularly noteworthy is the amount of time the OCC spent in the Summary of Comments responding to criticisms to its charter initiative for Fintech companies. Some commenters, according to the OCC, warned of the risks of granting special purpose national bank charters to Fintech companies, including the potential for consumer harm, the potential that entities engaged in predatory lending practices (e.g., payday lenders) would seek out a special purpose national bank charter, the potential for less-stringent supervision of Fintech companies and the OCC's authority to grant special purpose national bank charters. The OCC grouped its responses to the criticisms into ten categories:

- (1) Consumer Protection
- (2) Small Business Protections
- (3) Financial Inclusion
- (4) Regulatory and Supervisory Standards
- (5) Capital and Liquidity Requirements
- (6) Charter Application Process
- (7) Coordination Among Regulators
- (8) Ongoing Supervision
- (9) Chartering Authority
- (10) Separation of Banking and Commerce

### ***Consumer Protection***

In a simple statement, the OCC stated that it “disagreed” with criticisms that granting special purpose national bank charters to Fintech companies would cause consumer harm. Commenters expressed concern that a special purpose national bank charter would: (1) allow Fintech companies to avoid state consumer protection laws and state laws prohibiting unfair or deceptive acts or practices (“UDAP”), (2) weaken states’ ability to enforce consumer protection laws by removing visitorial oversight and (3) encourage charter shopping because of the federal preemption that national banks enjoy. To address these criticisms, the OCC noted that Fintech companies approved for special purpose national bank charters would be subject to “consistent federal consumer protection standards and federal supervision and regulation” and, in fact, the OCC enforces the Federal Trade Commission Act (“FTC Act”), which includes UDAP prohibitions. Dismissing state regulators’ criticisms, the OCC made clear that many state UDAP laws “borrow” language from the FTC Act and “explicitly reference FTC standards.”

The OCC also noted that federal preemption would apply to special purpose national banks in the same manner that it applies to national banks, including the applicability of certain state laws to national banks, such as fair lending, debt collection and taxation laws. Finally, the OCC addressed concerns from commenters that special purpose national bank charters would be available to Fintech companies that engage in “predatory” lending practices. The OCC stated that it currently does not, and would not for Fintech companies, approve charter

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applications from any company that planned to offer financial products and services with predatory, unfair or deceptive features.

## ***Small Business Protections***

In response to requests for the OCC to impose consumer protections for certain small business lending programs, and other commenters' views that small business borrowers were sufficiently protected under existing laws, the OCC stated that it would take "appropriate supervisory action" to ensure compliance with laws that affect small business borrowers and expects special purpose national banks involved in lending to provide sufficient disclosures and clear information to all borrowers. The OCC also noted that it would look favorably on a charter applicant's commitment to educating small business borrowers.

## ***Financial Inclusion***

To address commenters' concerns of imposing inflexible financial inclusion requirements on charter applicants, and to require business plans that include measurable goals with input from the community, the OCC stated that it not only expects a formal commitment to, and plan for, financial inclusion from charter applicants engaged in lending or providing financial services to consumers or small businesses, but it also expects financial inclusion to be a component of the applicant's business plan. The Draft Supplement contains the OCC expectations with respect to the financial inclusion requirement, including the evaluation factors (e.g., applicant's ability, efforts and commitment to meeting community financial needs).

## ***Regulatory and Supervisory Standards***

The OCC balanced concerns from commenters on the need to require charter applicants to meet the same high standards for safety, soundness and fairness as other federally chartered banks, with the concerns that the OCC should be flexible in its regulation and supervision of Fintech companies, particularly start-ups. The OCC restated its position that Fintech companies granted special purpose national bank charters would be subject to the same standards of safety, soundness and fairness as other federally chartered banks.

## ***Capital and Liquidity Requirements***

The OCC made clear that special purpose national bank charters would be subject to the leverage and risk-based capital requirements in the OCC's rules in 12 CFR Part 3; however, in addressing the issues raised by commenters to make capital requirements commensurate with the scope of the activities contemplated by charter applicants, the OCC plans to tailor capital requirements to capture the different risks associated with limited balance sheets or nontraditional strategies. Notably, the OCC stated that in some circumstances the capital requirements in 12 CFR Part 3 may not be sufficient for measuring capital adequacy of some charter applicants and, in those cases, the OCC will use alternative approaches to determine adequate capital requirements, which the OCC stated it has "considerable experience" doing with other national banks.

In the same regard, the OCC will consider the charter applicant's specific business model when evaluating the applicant's liquidity profile and liquidity risk management. The OCC expects applicants to consider and address projected borrowing capacity under both normal market conditions and adverse market conditions and, similar to other national banks, establish comprehensive contingency funding plans.

## ***Charter Application Process***

To counter commenters' concerns that, without a clear understanding of the standards that would apply during the application process for a special purpose national bank charter, and without consistent treatment among charter applicants, the OCC would be in a position to pick "winners and losers," the OCC pointed to the Draft

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Supplement, which outlines the factors the OCC will consider in reviewing applications, and the availability of the Office of Innovation and pre-filing meetings as ways in which charter applicants can obtain additional information on the application process. Ultimately, the OCC stated that it will approve charter applications for any company that has a reasonable chance of success, will provide fair access to financial services, will ensure compliance with law and will promote fair treatment of customers and foster healthy competition.

## ***Coordination Among Regulators***

The OCC agreed with commenters urging the OCC to coordinate with other federal and state regulators for clarity and consistency in the regulation of Fintech companies. The OCC will coordinate with other federal regulators, including facilitating simultaneous consideration of applications that may be required by other regulators.

## ***Ongoing Supervision***

The OCC responded to commenters' concerns that the OCC did not have the necessary resources or expertise to properly supervise Fintech companies by stating that it has an "experienced" and "knowledgeable" examination team and has the "technical expertise in a number of areas" for newly chartered special purpose national banks. The OCC also highlighted that it has "significant" experience assisting national banks in assessing and managing risks related to the use of technology service providers and other third parties. The OCC will, through its Responsible Innovation initiative, consider ways in which its current supervisory procedures could be improved by technology.

## ***Chartering Authority***

Several commenters, notably the CSBS and the New York DFS, expressed concern that the OCC did not have the statutory authority to grant special purpose national bank charters to non-deposit taking entities. The OCC reiterated that it has "broad authority" under the National Bank Act ("NBA") to grant charters for national banks that engage in the "business of banking," which the OCC has interpreted to include any of the three core banking functions (i.e., receiving deposits, paying checks or lending money). The OCC also reiterated its belief that the NBA does not require banks to take deposits in order to be engaged in the business of banking, and, as noted above, the OCC defined special purpose national banks, for purposes of its charter initiative, as entities that do not take deposits.

## ***Separation of Banking and Commerce***

Similarly, several commenters raised the issue that granting national bank charters to non-depository entities had the potential to "erode the traditional separation of banking and commerce." The OCC highlighted its guiding principle that it would not approve charter applications that would inappropriately commingle banking and commerce because such applicants "could introduce into the banking system risks associated with non-banking related commercial activities, interfere with the efficient allocation of credit through the U.S. economy and foster anti-competitive effects and undesirable concentrations of power."

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The OCC's Draft Supplement and Summary of Comments seem to be an attempt by the OCC to address criticisms of its charter initiative and also to set forth its precise regulatory approach to granting special purpose national bank charters to Fintech companies. Fintech companies considering special purpose national bank charters should continue to monitor developments with respect to the OCC's Fintech charter initiative.

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