

Alert | Financial Regulatory & Compliance

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OCC To Begin Accepting National Bank Charter Applications from Financial Technology Companies

On July 31, 2018, the federal Office of the Comptroller of the Currency (OCC) announced that it would begin accepting applications for special purpose national bank (SPNB) charters from financial technology companies (Fintechs) that are engaged in the business of banking but that do not take deposits. The announcement was documented in a policy statement¹ and implemented through a supplement to the OCC's *Comptroller's Licensing Manual*.² Applicants must publish notice of the filings of their Fintech charter applications and make them available for a 30-day public comment period, commencing from the date of publication of the notice. The OCC states that it "seeks to make a decision on a complete and accurate application within 120 days after receipt or as soon as possible thereafter." In other words, the OCC has given itself a very flexible period of time in which to approve or reject a charter application.

As a result of the OCC's announcement, for the first time ever, money transfer firms, online consumer and commercial lenders, virtual currency exchangers, and other Fintechs -- instead of being licensed, regulated, and examined by up to 50 different state regulators -- can avail themselves of a "one-stop

¹ See OCC, *Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters* (July 31, 2018), available at: <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/pub-other-occ-policy-statement-fintech.pdf>.

² See OCC, *Comptroller's Licensing Manual Supplement: Considering Charter Applications From Financial Technology Companies* (July 31, 2018), available at: <https://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-considering-charter-applications-fintech.pdf>.

shopping” license where the OCC is the sole licensing authority, sole regulator, and sole examiner. Start-up Fintechs that are approved for an SPNB charter will no longer be forced to maintain state licenses or partner up with a bank to launch their services.

Background

In December 2016, the OCC announced it was exploring the granting of the SPNB charter to Fintechs, and, in 2017, the OCC published draft licensing procedures for SPNB charters for Fintechs.³ In April 2017, a consortium of state bank regulators (the Conference of State Bank Supervisors, or CSBS) and the New York Department of Financial Services (NYDFS) separately filed actions in federal courts challenging the OCC’s authority to grant SPNB charters to Fintechs, claiming that the OCC acted beyond its legal authority under the National Bank Act. The federal courts dismissed the CSBS and NYDFS lawsuits as premature for litigation because the OCC had not formally adopted a chartering procedure at the time the lawsuit was filed.⁴ Because the OCC has now adopted licensing procedures for SPNB charters for Fintechs, it is possible that state financial regulators and possibly consumer advocates and some financial service providers will sue the OCC in the near future to block it from issuing any SPNB charters to Fintechs. Such litigation could delay the final issuance of SPNB charters.

Legal Authority for the SPNB Charter

An SPNB is a national bank organized and governed by the National Bank Act that engages in a limited range of banking or fiduciary activities, targets a limited customer base, incorporates nontraditional elements, or has a narrowly targeted business plan. ***The OCC believes that because the National Bank Act defines the “business of banking” to include any of the three core banking functions of accepting deposits, making loans, or paying checks, to the extent the Fintech engages in any one or more of these activities, the Fintech may qualify for an SPNB charter.***⁵

Most Fintechs are not expected to accept deposits. However, online consumer-lenders clearly engage in the business of making loans, which is a core banking activity. Another core banking activity that the OCC expects Fintechs to engage in centers around the act of “paying checks,” an activity that the OCC construes much more broadly than the act of honoring a traditional check. With respect to paying checks, the OCC views the National Bank Act as sufficiently adaptable to permit national banks (including SPNBs) to engage in new activities as part of the “business of banking” or to engage in traditional activities in new ways.⁶ For example, OCC regulation authorizes national banks to perform, provide, or deliver, *through electronic means and facilities*, any activities that they are otherwise authorized to conduct.⁷ Therefore, the OCC views ***issuing debit cards or engaging in other means of facilitating payments***

³ See OCC Press Release (Oct. 26, 2016), available at: <https://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-135.html> and OCC, *Comptroller’s Licensing Manual Draft Supplement: Evaluating Charter Applications From Financial Technology Companies* (Mar. 15, 2017), available at: <https://www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf>.

⁴ See *Conference of State Bank Supervisors v. OCC*, No. 17-0763, 2018 WL 2023507 (Apr. 30, 2018) and *Vullo v. OCC*, 17 Civ. 3574, 2017 WL 6512245 (Dec. 12, 2017).

⁵ See OCC, *Policy Statement on Financial Technology Companies’ Eligibility to Apply for National Bank Charters* (July 31, 2018), available at: <https://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/pub-other-occ-policy-statement-fintech.pdf>.

⁶ See OCC, *Comptroller’s Licensing Manual Draft Supplement: Evaluating Charter Applications From Financial Technology Companies* (March 15, 2017), available at: <https://www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf>.

⁷ See 12 C.F.R. § 7.5002.

electronically to be the modern equivalent of paying checks.⁸ Thus, Fintechs that conduct money transmission activities or engage in virtual currency exchange may now be able to consider the SPNB charter as an alternative to cumbersome state-by-state licensing.

In the absence of an SPNB engaging in deposit taking, a Fintech will not need to obtain deposit insurance and will not be subject to the approval of the Federal Deposit Insurance Corporation (FDIC). Additionally, the lack of FDIC insurance should likely result in the SPNB not being a bank holding company subject to regulation by the Federal Reserve Board under the Bank Holding Company Act.

OCC Review of SPNB Charter Applications

In determining whether to approve an SPNB charter for a Fintech, the OCC will consider the following:

- **Organizers, Management, and Directors**

OCC expects them to be well-qualified, with diverse experience in relevant areas. Although the OCC would expect experience in banking or broader financial services, other relevant experience will depend on the specific products or services to be offered by the SPNB. Because Fintechs are technology-driven, substantial technical knowledge, skills, and experience will be necessary.

The OCC will also apply, as appropriate, criteria and qualifications for SPNB organizers, managers, and directors that it generally applies to national banks. Such criteria and qualifications may include the submission to the OCC of the following items by each organizer, director, executive officer, and controlling shareholder:

- an Interagency Biographical and Financial Report containing detailed financial data;
- fingerprint cards;
- IRS Tax Check Waivers; and
- a consent to a general background search. Directors may also be subject to certain U.S. citizenship and residency requirements.

- **Business Plan**

Fintechs seeking the SPNB charter must submit a comprehensive business plan that addresses the following, among other things:

- the reason for seeking the SPNB charter and the proposed activities;
- the goals and objectives of the SPNB and how these will be met and measured;
- the market to be served and the products/services to be offered;
- the customer base and forecast of market demand, economic conditions, competition, and financial projections (under normal and stressed conditions);
- the risk management framework to identify, measure, monitor, and control risks;
- the proposed internal system of controls to monitor and mitigate risk, including management information systems;
- independent testing of the business activities, systems and controls, and compliance management systems; and

⁸ See OCC, *Comptroller's Licensing Manual Draft Supplement: Evaluating Charter Applications From Financial Technology Companies* (March 15, 2017), available at: <https://www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf>.

- any functions or services that will be outsourced and risk management processes to be implemented.

Along with the business plan, the Fintech should include a risk assessment that covers all risks inherent in the proposed business model, the products, and services. The risk assessment should also cover risks relating to third-party service providers, cybersecurity, Bank Secrecy Act/anti-money laundering requirements, Office of Foreign Assets Control economic sanctions obligations, consumer protection, and fair lending. The risk assessment must identify the SPNB’s risk appetite and mitigating controls for identified risks. Because of the increasing risk of cyber attacks faced by financial institutions, Fintechs should be prepared to provide comprehensive, technical information regarding cybersecurity controls and cybersecurity training for employees.

- Capital

The OCC expects SPNBs to maintain minimum and ongoing capital levels that are commensurate with the risk and complexity of the SPNB’s activities. The OCC will apply minimum leverage and risk-based capital requirements that it applies to all national banks.⁹ However, the OCC recognizes that these requirements measure regulatory capital levels relative to an entity’s assets and off-balance-sheet exposures but may not be sufficient for measuring capital adequacy for some SPNBs that may, for example, have limited on-balance-sheet assets or nontraditional strategies. As a result, ***applicants will be expected to propose a minimum level of capital that the SPNB will meet or exceed at all times.*** Minimum level of capital must be determined through a capital adequacy assessment that considers quantitative and qualitative factors, such as the volume of off-balance-sheet activity conducted and the risks associated with the business plan. The OCC will review and evaluate the applicant’s capital adequacy assessment.

The business plan to be submitted with the application should discuss the minimum capital levels that the SPNB will adhere to until it achieves and sustains profitable operations, as well as the minimum capital levels to be adhered to after profitability. The business plan should also address adverse market conditions that could deplete capital, and should also consider the following:

- On- and off-balance-sheet composition, including credit risk, concentration risk, and market risk.
- Operations risk, including third-party relationships and compliance risk associated with nontraditional products, services, or operating characteristics.
- Proposed activities and anticipated volume (new accounts, transactions) and impact on capital.
- Plan and prospects for growth, including any material action necessary to address business activity that is either below or above expectations and management’s past experience in managing growth.
- Stability or volatility of sources of funds and access to capital.

⁹ For example, the OCC requires that deposit-taking national banks with less than \$250 billion in total consolidated assets and less than \$10 billion in total foreign exposure maintain:

- (1) Minimal capital ratios of:
 - (a) common equity tier 1 (CET1) capital ratio of 4.5 percent (CET1 capital/total risk-weighted assets (RWA));
 - (b) tier 1 capital ratio of 6 percent (tier 1 capital/total RWA);
 - (c) total capital ratio of 8 percent (total capital divided by total RWA); and
 - (d) leverage ratio of 4 percent (tier 1 capital divided by [average total consolidated assets as reported on the SPNB’s call report less certain deductions]); and
- (2) A capital conservation buffer of 2.5 percent (this is capital that must be held *in addition to the minimum capital ratio described above* in order to avoid restrictions on capital distributions and discretionary bonus payments). See 12 C.F.R. Part 3, subparts B; and 12 C.F.R. § 3.11.

Fintechs should be aware that, if the OCC grants a preliminary conditional approval for an SPNB charter, approval will include a condition specifying a ***minimum capital level that the SPNB will be required to maintain or exceed at all times***. The OCC expects that capital in an SPNB would increase beyond the initial minimum amount as the size, complexity, and corresponding risks of the SPNB evolve.

- Liquidity

Because SPNBs do not rely upon FDIC-insured deposits and are likely to utilize funding that is potentially more volatile in certain environments, SPNB applications should discuss how the SPNB can be funded and maintain sufficient liquidity under stressed conditions. The term “liquidity” refers to the SPNB’s capacity to readily meet its cash and collateral obligations at a reasonable cost without adversely affecting either daily operations or its financial condition. The OCC may impose requirements to the SPNB’s funding model, structure, and risks to ensure that it maintains adequate liquidity at all times and in all economic environments.

- Financial Inclusion

Unlike with traditional national bank charter applicants, the OCC expects Fintechs seeking an SPNB charter to demonstrate a commitment to financial inclusion that includes providing or supporting fair access to financial services and fair treatment of customers. SPNB applicants should describe the proposed goals, approaches, activities, milestones, commitment measures, and metrics for serving the anticipated market and community consistent with the SPNB’s activities, business model, and product and service offerings.

During the organization phase, following preliminary conditional approval, SPNBs will be expected to develop policies and procedures that address their commitment to financial inclusion. The OCC may impose financial inclusion commitment-related conditions as part of any final approval of an SPNB charter and will review compliance with such conditions during the examination process.

- Contingency Planning

Before receiving final approval for a charter, an SPNB will be required to develop a contingency plan to address significant financial stress that could threaten its viability. The contingency plan should be tailored to the SPNB’s business and should outline strategies for restoring the SPNB’s financial strength, including options for selling, merging, or liquidating the SPNB in the event that recovery strategies are not effective. The OCC’s final approval will require the SPNB to implement and adhere to the contingency plan. SPNBs are expected to review their contingency plans on an annual basis and to update it, as needed. Significant changes to contingency plans require non-objection of the appropriate supervisory office.

- Coordination with Other Regulators

Depending on the structure of the Fintech, regulators in addition to the OCC may have oversight and supervisory roles over the proposed SPNB. In considering applications for SPNB charters, the OCC will coordinate, as appropriate, with other regulators to facilitate consideration of any applications or approvals that may be required by those regulators.

- Continuation of Remedies

The OCC may deny an SPNB charter application to applicants with pending enforcement actions with respect to significant supervisory matters. Otherwise, following consultation with the relevant regulator, the OCC will ensure that an obligation to remediate or pay penalties for any violations or deficiencies cited or identified by another regulator is carried forward and enforced through conditions imposed on an approval of an SPNB charter.

In light of the relatively unique business models that many Fintechs are expected to bring to the market under an SPNB charter, we expect the OCC to impose (by condition or otherwise) risk management standards that are tailored to each specific Fintech.

Supervision of Approved SPNBs

Fintechs that are approved for the SPNB charter will be supervised like similarly situated national banks, under a scheduled supervisory cycle that includes at least annual on-site examinations and periodic off-site monitoring. Fintechs will be responsible for paying for all costs associated with OCC examinations. Like all de novo deposit-taking national banks, newly chartered SPNBs will be subject to rigorous ongoing oversight to ensure that the SPNB's management and board is properly executing the SPNB's business strategy and meeting performance goals.

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