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## *State Regulators Mount Counter-Offensive Seeking to Stop OCC's Fintech Charter*

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In an attempt to prevent the Office of the Comptroller of the Currency ("OCC") from seizing traditional turf from state regulators, the Conference of State Bank Supervisors ("CSBS") filed a lawsuit<sup>1</sup> on April 26, 2017 challenging the OCC's new Special Purpose National Bank ("SPNB") charter (the "SPNB Charter") designed to charter fintech companies (the "CSBS Suit").<sup>2</sup> The CSBS represents various state bank regulators, most of which maintain state licensing regimes for consumer and commercial lenders, money transmitters, entities engaging in foreign exchange services, virtual currency companies, and other types of fintech companies.

In sum, the CSBS Suit augments recent public statements by state bank supervisors<sup>3</sup> indicating that the OCC lacks the statutory power to charter a SPNB, and thus the OCC's actions to facilitate the creation of SPNBs must be enjoined. This has been the articulated position of the CSBS for years.<sup>4</sup> The CSBS further alleges that the OCC failed to comply with the Administrative Procedure Act in adopting its chartering procedures for SPNBs and, as such, the SPNB Charter must be voided. Finally, the CSBS alleges that the OCC's actions are unconstitutional and therefore void, as Congress has not authorized the OCC to charter SPNBs and thus the OCC lacks Congressional authority to preempt state law.

### **Does the Business of Banking Require Receiving of Deposits?**

The crux of CSBS's arguments centers on the OCC's limited authority to charter national banks that are engaged in the "business of banking." The CSBS Suit argues that, in order to be deemed to engage in "the business of banking," a financial services company must accept deposits unless Congress explicitly authorizes otherwise (such as when national trust banks, which do not engage in deposit taking, were expressly authorized by Congress in 1978 following the OCC's failed attempt to charter them by regulation). Financial institutions that accept deposits are also subject to regulation by the Federal Deposit Insurance Corporation, and the corporate shareholders of deposit taking institutions are also subject to regulation by the Board of Governors of the Federal Reserve System.

The OCC, on the other hand, has stated in its whitepaper entitled *Exploring Special Purpose National Bank Charters for Fintech Companies*, that the OCC has the authority to charter a SPNB as long as such entity is engaged in any one of the three core banking functions—receiving deposits, paying checks or lending money, citing to a regulation it promulgated in 2003 that provides that the OCC may charter a special-purpose bank that limits its activities to "any other activities within the business of banking," provided that the special-purpose bank conducts "at least one of the following three core banking functions: receiving deposits; paying checks; or lending money."<sup>5</sup> A bank receiving deposits



would be clearly authorized under the National Bank Act, and subject to FDIC regulation and its corporate shareholder to Federal Reserve regulation. CSBS's lawsuit, however, is focused on preventing the OCC from chartering a national bank that only pays checks or lends money—activities engaged in by fintechs that are involved in payments, money transmission, or online lending.

The Comptroller of the Currency, noted in a speech given two days after the CSBS filed its lawsuit that the business of banking is dynamic and should not be regarded as static.<sup>6</sup> The Comptroller noted that the federal banking system has served as a common source of strength for communities across the country and for the broader national economy for more than 150 years because it was allowed to adapt to meet the evolving needs of consumers.<sup>7</sup> At the same conference, Federal Reserve Governor Lael Brainard noted that the OCC SPNB proposal, when finalized, would require close examination by the Board of Governors to determine whether fintech-chartered entities would become Federal Reserve members or have access to Federal Reserve accounts and services.<sup>8</sup> As national banks must be members of the Federal Reserve,<sup>9</sup> the Federal Reserve would have an effective approval right over any new SPNB; if the Federal Reserve declined to extend membership to a SPNB, such SPNB could not operate.<sup>10</sup>

The OCC's SPNB initiative was clearly designed to provide a national charter to entities engaged in providing financial services using technology. Nationally-chartered banks operate without regard to state boundaries, and many of the laws of the 50 states and the territories of the U.S., including state licensing requirements that interfere with their operations, are deemed to be preempted. Accordingly, if such fintechs are presented the option to avoid 50-state regulation by establishing a federally-regulated SPNB, a shift away from state licensing and regulation may result, thereby marginalizing to some extent the role of states in the regulation of payments, money transmission, and online lending.

CSBS argues that state authorities have successfully regulated nonbanks for many years, imposing safety and soundness requirements, and enforcing both state and federal consumer protection laws. CSBS raises the concern that the draft supplement to the OCC's *Licensing Manual for Evaluating Charter Applications From Financial Technology Companies*<sup>11</sup> discusses that compliance with federal laws will be mandated only through operating agreements individualized to the business model of each SPNB Charter applicant, which the CSBS argues would create an uneven playing field among fintech. More importantly, the CSBS expresses concern that SPNBs will operate outside the bounds of existing state regulation, creating conflicts between applicable federal law and potentially inconsistent state laws, which would be deemed to be preempted. While preemption of inconsistent state law would permit a SPNB to operate on a uniform basis nationwide, without regard to most individual state law, CSBS asserts the absence of clear evidence that Congress intended to allow the OCC to preempt state law.

## **Preservation of the Regulatory *Status Quo* or Is There a Better Way?**

Clearly, CSBS is mounting a legal counter-offensive to the OCC's attempt to license entities historically regulated by the states. While state and federal regulators currently are arguing as to who should control the regulatory sandbox, the true focus of regulatory concern should be on the development of innovative financial services, consistent with safe and sound operations, with viable and effective consumer protections. While, historically, payments companies and lenders have been regulated by the states, the OCC's SPNB Charter has sparked a dialogue as to whether the current regulatory system for fintech operations is viable. Innovation of financial services may also require innovation of financial services regulation. Rather than trying to pigeon-hole financial services into traditional



regulatory models, perhaps it is time for regulators, at both the federal and state level, to act in concert to develop a system of licensing, regulation, and enforcement for financial products and services that is efficient, not redundant, and minimizes the regulatory burden on financial institutions while it provides for the continued protection of consumers. Setting aside the merits of the pending suit, the right policy prescription will likely involve the federal and state governments working together to minimize the regulatory burden while appropriately protecting the safety and soundness of FinTechs and provide necessary consumer protection.



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<sup>1</sup> See *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency*, Case 1:17-cv-00763 (U.S. D.C. for District of Columbia) (Apr. 26, 2017).

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- <sup>2</sup> The OCC's proposal is discussed in our prior *StayCurrent*, *The OCC's Proposed Fintech Charter: If It Walks Like a Bank and Quacks Like a Bank* (Dec. 13, 2016), available at <https://www.paulhastings.com/publications-items/details/?id=2b1eeb69-2334-6428-811c-ff00004cbded>.
- <sup>3</sup> See, e.g., Comments of the New York Department of Financial Services to the OCC (Jan. 17, 2017).
- <sup>4</sup> See, e.g., Letter of the Conference of State Bank Supervisors to OCC, *Exploring Special Purpose National Bank Charters for Fintech Companies* (Jan. 13, 2017), available at <https://www.csbs.org/news/press-releases/pr2016/Documents/CSBS%20Comment%20Letter--OCC%20White%20Paper-Exploring%20Special%20Purpose%20National%20Bank%20Charters%20for%20Fintech%20Companies.pdf>; Letter of the Conference of State Bank Supervisors to OCC, *Receiverships for Uninsured National Banks* (Nov. 14, 2016), available at <https://www.csbs.org/regulatory/policy/Documents/2016/CSBS%20Comment%20Letter%20on%20OCC%20Receiverships%20for%20Uninsured%20National%20Banks%20NPRM.pdf>.
- <sup>5</sup> See 12 C.F.R. § 5.20(e)(1). The CSBS strenuously objected to Section 5.20(e)(1) when it was proposed, citing too many of the same arguments used in its current suit.
- <sup>6</sup> See [Remarks by Thomas J. Curry](#) at FinTech and the Future of Finance Conference (April 28, 2017).
- <sup>7</sup> Id.
- <sup>8</sup> See [Remarks by Lael Brainard](#) at FinTech and the Future of Finance Conference (April 28, 2017).
- <sup>9</sup> See 12 U.S.C. § 282.
- <sup>10</sup> The Federal Reserve has exercised its authority to deny membership or services to lawfully chartered financial institutions, thus denying their ability to operate. In 2015, the Federal Reserve Bank of Kansas City denied a master account to The Fourth Corner Credit Union, which planned to service Colorado's legal marijuana business.
- <sup>11</sup> See [Comptroller's Licensing Manual Draft Supplement Evaluating Charter Applications From Financial Technology Companies](#), (March 2017).