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Legal Sidebar

Court Battle for Fintech Bank Charters to Continue

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The Office of the Comptroller of the Currency (OCC) plans to appeal an October district court judgment holding that the agency lacks the authority to grant national bank charters to financial technology companies (fintechs) that do not take deposits. Fintechs provide the financial services sector with digital and software technologies, and businesses and consumers with web-based, technology-enhanced financial services. Chartering a fintech as a national bank would mean that the fintech would benefit from federal preemption of varying state licensing and consumer protection requirements. Moreover, a national bank charter carries with it the ability to open a Federal Reserve master account, which provides direct access to the payments system for financial transactions.

Joseph Otting, Comptroller of the Currency, announced an intention to file an appeal to the U.S. Court of Appeals for the Second Circuit. This Sidebar will briefly summarize the background of this litigation and the specifics of the trial court decision, as well as potential considerations for Congress.

Background

The OCC bases its authority to issue bank charters to fintechs on the National Bank Act (NBA), which authorizes the agency to charter national banks "to commence the business of banking" and refers to national banks as "associations to carry on the business of banking." The chronology of OCC's efforts to develop a fintech bank charter is as follows:

- In 2003, OCC promulgated a regulation, 12 C.F.R. § 5.20(e), authorizing "special purpose national banks" (SPNBs). The regulation specifies that an applicant for a SPNB charter must "conduct at least one of the following core banking functions: receiving deposits, paying checks, or lending money." At the time of the rulemaking in 2003, no reference was made to fintechs.
- In December 2016, OCC solicited public comments on the prospect of using the 2003 regulation to offer a SPNB charter for fintech companies providing web-based financial services such as marketplace lending, digital payments, digital currency, and crowdfunding. OCC explained that it was proposing SPNB fintech charters as a means of offering regulatory consistency, preempting conflicting state licensing and consumer protection requirements, and ensuring fintechs and consumers are covered by the rigorous

safety and soundness, consumer protection, and supervisory standards applicable to national banks.

- In March 2017, after weighing public comments, OCC issued a draft supplement to the national bank Licensing Manual outlining how the agency would evaluate applications from fintechs and how it would apply national bank regulatory standards to chartered fintechs.
- In April 2017, the Conference of State Bank Supervisors (CSBS) and the New York State Department of Financial Services (NYS DFS) filed suits in the U.S. District Court for the District of Columbia and the U.S. District Court for the Southern District of New York (SDNY), respectively, challenging OCC's authority to issue banking charters to fintechs under the NBA. However, both suits were dismissed on ripeness grounds because OCC had not actually issued SPNB charters to fintechs.
- In July 2018, OCC announced that it would begin offering a SPNB charter to fintechs, provided they are conducting one or more of the three core banking functions identified in the SPNB regulation. As a result, fintechs would be eligible for a SPNB charter if they made loans or paid checks, even if they did not accept deposits. With the announcement, OCC finalized the March 2017 supplement to the Licensing Manual that would subject fintech SPNBs to many of the same regulatory and supervisory standards as other national banks. For example, although non-depository fintech SPNBs would not be subject to the Federal Deposit Insurance Corporation's resolution authority for insured depository institutions, the supplement would require them to develop contingency plans should there be a need for orderly downsizing or liquidation.
- After OCC issued the final supplement, CSBS and NYS DFS again filed suits in separate federal courts to challenge OCC's fintech charter authority. On May 2, 2019, the SDNY held that the OCC regulation authorizing SPNB charters for non-depository fintechs exceeded the agency's authority under the NBA. In contrast, on September 3, 2019, the U.S. District Court for the District of Columbia dismissed the CSBS suit as unripe because OCC had not issued a fintech bank charter, and CSBS lacked standing because no member of the CSBS was able to assert an injury in fact.
- On October 21, 2019, the SDNY issued a judgment in favor of NYS DFS, based on its May 2, 2019, decision. The case is headed for appeal to the Second Circuit and is discussed in the next section of this Sidebar.

NYS DFS Suit Challenging Fintech SPNB Charter

The NYS DFS challenged the OCC's decision to charter fintechs on two grounds. First, the DFS argued that the OCC lacked authority under the NBA to charter non-depository institutions. Second, the DFS argued that if the NBA grants the OCC this authority, it violates the Tenth Amendment "because it creates a conflict with state law [regulating non-depository fintechs] that Congress did not authorize." While the SDNY rejected the NYS DFS's Tenth Amendment claim, it agreed that the NBA does not allow OCC to charter non-depository institutions. Specifically, the court held that the NBA provision allowing OCC to charter firms engaged in the "business of banking" does not encompass firms that do not accept deposits. In reaching this conclusion, the district court relied on 19th century dictionaries and the NBA's post-enactment history, which the court read as suggesting that the phrase "business of banking" unambiguously excludes non-depository institutions. Because of the statute's clear meaning, the district court rejected the OCC's argument that its interpretation was entitled to deference under the *Chevron* framework, which requires courts to defer to an agency's statutory interpretation only in cases of genuine ambiguity.

October 21, 2019, Judgment. After the SDNY's decision, the parties negotiated a stipulated final judgment. Each party proposed a version of the judgment for the court's consideration. OCC sought to limit the effect of the ruling and proposed setting aside the regulation only "with respect to all fintech applicants seeking a national bank charter that do not accept deposits . . . and that have a nexus to New York." The court rejected this and issued a broad judgment ordering the regulation to be "set aside with respect to all fintech applicants seeking a national bank charter that do not accept deposits."

Considerations for Congress

As the litigation continues, Congress may consider clarifying the role of OCC in chartering fintechs or crafting a framework to encourage and regulate various forms of financial technology and innovation. Until the fintech charter issue arose, OCC had chartered only two types of non-depository banks (i.e., trust banks and banker's banks) and only upon express authorization from Congress. Legislation could explicitly authorize OCC to charter fintechs. Some Members of Congress have proposed measures to increase regulatory certainty for fintechs.

Congressional hearings have also examined aspects of the fintech industry, including state-level regulatory developments. In June 2019, the House Financial Services Committee's Task Force on Financial Technology conducted a hearing on "Overseeing the Fintech Revolution: Domestic and International Perspectives on Fintech Regulation." At that hearing, CSBS testified on the states' progress under the CSBS Vision 2020, towards harmonizing state regulation of fintechs and nonbanks, which includes an effort to draft a Model State Payments Law to bring greater uniformity to the regulation of non-bank money transmitters. And in September 2018, the Senate Banking Committee held a hearing on "Fintech: Examining Digitization, Data, and Technology." At that hearing, one witness supported moving toward standardization of consumer financial data without specifically advocating any particular new legislation or regulation. Another witness, however, cautioned that existing laws may be sufficient to mitigate certain risks from fintech innovation, and that regulatory changes are warranted "only if existing law is proven to be inadequate and the benefits of changing the law will outweigh the costs."

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