Fintech Charter Fight Goes Beyond Regulatory Authority

Law360, (March 7, 2019)

Sarah Aucterlonie

Tony Arias

The final brief was recently filed in a multiyear battle between states and the Office of the Comptroller of Currency for regulatory authority over financial technology firms.[1] The OCC is an independent department within the U.S. Department of the Treasury that regulates and charters national banks under its authorizing statute, the National Bank Act, or NBA.[2]

In July 2018, the OCC made a move that threatens state oversight of nonbank lenders when it announced it would accept applications for special purpose national bank, or SPNB, charters. With the SPNB charter, fintech firms that engage in one of the two core banking activities of paying checks or lending money, but do not take deposits, can obtain a charter and be immune from some state regulation. The SPNB charter is not available to companies that take deposits.

Fintechs use technology to reinvent and improve financial services such as online lending, automated insurance, mobile-payment systems, and securities trading. Currently, fintechs must receive and pay for licenses state by state, as well as undergo examinations and investigations by each state's authorities.

The Conference of State Bank Supervisors v. OCC lawsuit is not just a fight over regulatory authority; an OCC win would reduce the barriers to entry for fintechs by establishing a single regulator. While this would be a boon for financial services innovation, it could have an economic impact on banks and nonbank competitors, as well as slash the number of cops on the beat who are enforcing financial services laws.

The OCC has yet to issue an SPNB charter, and the CSBS is trying to prevent the OCC from doing so. CSBS is a national organization supporting state regulators who oversee the financial industry. CSBS advocates for the role of state supervision in protecting consumers in the regulators' respective states. CSBS argues in CSBS v. OCC that nondepository institutions do not fall within the NBA's use of the term "business of banking" because the NBA requires banks to take deposits; therefore, the OCC ought to be enjoined from extending the national charter to nondepository firms traditionally regulated by the states.

What's Really at Stake

This case is about federal preemption of state regulatory authority. State governments will lose to the federal government the power to license, examine and enforce state laws against fintech firms. States' loss of authority has implications for these states' funding mechanisms, enforcement of state-specific lending laws, and state agencies' ability to request documents and investigate fintech firms.

Moreover, the Consumer Financial Protection Bureau only has authority to supervise and begin enforcement investigations against "very large banks," and receiving an SPNB charter could cede CFPB's investigatory powers over fintech firms exclusively to the OCC.

Fintechs and those supporting financial innovation hail the SPNB charter as a panacea to the current quagmire of inconsistent state laws and the expensive 54-state and territory licensing process. It also staves off state examinations. Many large nonbank financial services firms dedicate year-round offices in their headquarters for state regulators to occupy during exams. Dealing with the multitude of state regulators is a cumbersome and distracting cost of doing business for many fintech firms.

In contrast, state regulators and enforcers view themselves as vital to regulatory oversight and enforcement. CSBS President and CEO John Ryan warned, “Lest we forget, in the early 2000s the OCC enabled national banks to ignore state predatory lending laws, a move that contributed to the U.S. financial crisis and the largest number of home foreclosures since the Great Depression. History cannot be allowed to repeat itself.”

To assuage state concerns, OCC spokesman Bryan Hubbard stated in the press, “State laws that address anti-discrimination, fair lending, debt collection … would also apply to [SPNB] banks.” Moreover, Hubbard states, “State laws that prohibit unfair or deceptive acts or practices that address concerns such as material misrepresentations and omissions about products and services … also generally apply to national banks.”

Thus, any concern that consumers will be harmed by this new program is wholly unsupported.

Fintechs Are Here to Stay

Fintechs have injected efficiency and innovation in the financial services arena by providing consumers with an array of options for financial activities, such as peer-to-peer money transmissions (think Venmo), short-term, small-amount loans (Kabbage), and online investment opportunities (Wealthfront). A U.S. Department of Treasury report on fintech firms found that “[e]arly evidence indicates that these new lending channels have provided opportunities to expand credit to underserved segments.”[3].

Traditional banks are now taking notice because fintechs are increasingly taking market share from them, particularly in retail lending. The SPNB charter would allow fintechs to compete even better with these traditional banks once they receive the same federal immunity from state restrictions that nationally chartered banks enjoy.

To counter this competitive insurgency, many banks are partnering with fintechs while others are seeking to implement technological innovations to the services they already provide — e.g., Bank of America has spent $20 billion on new technology since 2012. Other banks are focused on improving the banking experience at brick-and-mortar locations by offering digital self-service screens, extending office hours, providing ATMs that enable users to virtually meet with a representative, and providing branches that could double as cafes.

Yet not everyone agrees this is the right approach. A comment to a September American Banker article summed it up nicely: “Why are we fixated on making the branch more appealing? It’s reminiscent of Blockbuster investing in remodeling and adding products to its video rental stores, when consumers were flocking to streaming services.”

For now, banks will continue seeking ways to avert the threat fintech firms pose to their business models. How the government chooses to regulate these up-and-coming companies will determine what their impact in the financial sector will be and how quickly it will happen.

The Case

In 2018, the OCC announced it was accepting applications from fintechs for an SPNB charter.[4] Fintechs that decide to pursue the SPNB charter will be supervised like traditional national banks, meaning fintechs may face various capital, liquidity or risk management requirements. The OCC had been broadcasting this move for some time, which CSBS initially challenged in CSBS v. OCC[5]. The court ultimately dismissed CSBS v. OCC I because the issue was not ripe for review.

CSBS' Complaint

After the OCC issued its policy statement, CSBS filed another complaint in the U.S. District Court for the District of Columbia, arguing the OCC lacks congressional authority to grant fintech firms national bank charter status.[6]

The NBA and other federal banking laws authorize the OCC to charter institutions involved in the "business of banking." CSBS argues the "business of banking" requires the entity to receive deposits. The OCC's new charter, however, allows fintech firms that do not receive deposits, but engage in other banking activities like lending, to obtain nationally chartered status. This, CSBS argues, is not within the powers Congress created for the OCC. Furthermore, according to CSBS, this new charter would allow fintechs to avoid state regulations that prevent predatory lending and other consumer protection violations.

The NBA and other federal laws preempt state laws — e.g., usury laws, which govern interest rates that financial institutions can charge on loans. Under NBA Section 85, national banks may charge out-of-state customers interest rates permitted in the bank's home state, even if those interest rates violate the usury laws of the customer's state.

OCC's Motion to Dismiss

In the OCC's motion to dismiss, it argues the case — similar to CSBS v. OCC I — is not ripe for review because the OCC has yet to issue an SPNB charter. Consequently, CSBS also lacks standing because no injury has occurred. Since CSBS v. OCC I was dismissed, the OCC announced it would start accepting SPNB charter applications. But because the OCC has yet to issue an SPNB charter, OCC argues this case should be dismissed as well.

Second, even if the case is ripe and standing is established, the OCC moved to dismiss on the basis that its interpretation of "in the business of banking" is reasonable and entitled to Chevron deference. Under Chevron U.S.A. Inc. v. NRDC Inc.,[7] agencies can interpret ambiguous statutory provisions under the agency's authority if the interpretation is reasonable in light of the text, nature and purpose of the statute. The OCC argues that its "conclusion that a national bank need only be engaged in one of the three core banking functions — receiving deposits, paying checks or lending money — to be engaged in the

'business of banking' aligns with the context and structure of the [NBA] and controlling Supreme Court and D.C. Circuit caselaw."

CSBS responded standing exists because the OCC is now accepting SPNB charter applications; therefore, the matter is now ripe. Furthermore, CSBS argues the OCC's interpretation is erroneous given that a proper interpretation of that phrase through the NBA and other federal banking statutes illustrates that taking deposits is essential to be "in the business of banking."

The OCC replied to CSBS' response by reiterating that its interpretation is reasonable given precedent, arguing that CSBS' support for its interpretation relies too heavily on banking laws outside the NBA and stressing that the matter is still not ripe given the number of steps still required before a fintech acquires an SPNB charter.

Closing Thoughts

Innovation is oftentimes constrained by legal requirements that applied to old forms of doing business. Even more challenging to overcome are the rooted interests of the competing power players already established in the industry — government and corporations alike. Different state-by-state licensing requirements for financial services have proved cumbersome to fintech firms. According to these firms, the granular regulatory landscape has impeded growth and increased the costs of doing business.

Fintechs therefore advocate for less red tape because the old banking models are no longer capturing the entire availability of financial services. The OCC's action recognizes that fintechs represent new lending and payments models that require a different approach to regulatory oversight.

For now, the legal uncertainty surrounding fintech firms means they should tread cautiously to ensure compliance with applicable laws and regulations. Ultimately, the firms that best navigate the legal terrain will be the winners in this fast-growing industry.

Likewise, the SPNB charter may not be a good option for all fintech firms. Those fintechs that fall outside lending or accepting payments don't qualify for a SPNB charter. Obtaining state licenses for firms with a regional presence will be a better option for those firms because obtaining a handful of licenses will be less cumbersome than complying with the SPNB charter requirements.

On the other hand, some fintechs do business on a global or national scale. Naturally, they will prefer federal oversight rather than local oversight. An SPNB charter will be desirable to those firms because complying with the SPNB charter requirements will be less onerous than obtaining and then complying with numerous state licenses. Finally, fintech firms seeking an SPNB charter will need to consider not only the legal uncertainty surrounding the charters but also their requirements, such as capital, liquidity and risk-management restrictions. These restrictions may be cumbersome to some fintech firms whose services are limited.

Whatever the outcome of the case, the possibilities for fintechs to change the financial

services landscape will continue to grow. However, the battle for regulatory oversight will in large part determine how efficiently these new possibilities materialize.

Sarah Auchterlonie is a shareholder and Tony Arias is an associate at Brownstein Hyatt Farber Schreck LLP.

[1] Conference of State Bank Supervisors v. Office of the Comptroller of the Currency, 1:18-cv-02449 (D.C.D.C. Feb. 26. 2019)

[2] (12 U.S.C. § 21 et. seq.)

[3] U.S. DEPT. OF TREASURY, A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation, 89 (July 2018)

[4] Office of the Comptroller of the Currency, OCC Begins Accepting National Bank Charter Applications From Financial Technology Companies, NR 2018-74, (July 31, 2019), https://www.occ.gov/news-issuances/news-releases/2018/nr-occ-2018-74.html (last visited March 4, 2019).

[5] 313 F.Supp.3d 285 (D.D.C. 2018) (CSBS v. OCC I)

[6] See Compl. CSBS v. OCC, Case 1:18-cv-02449 (D.C.D.C. Oct. 25, 2018), (ECF No. 1).

[7] 467 U.S. 837 (1984)