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Fintech Charters

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Memorandum

TO:	Staffers to Senators Smith (R) and Roberts (D)
FROM:	Staff Counsel, Senate Banking Committee
DATE:	February 6, 2020
RE:	Upcoming Committee Hearing on Fintech Charters

The Senate Banking Committee is holding a hearing next week to discuss the Office of the Comptroller of the Currency's "Fintech Charter." The Committee has been hearing about advances in this sector in other parts of the world, such as the United Kingdom and China, and is concerned that the United States is falling behind as a global financial services leader.

In July 2018, the Office of the Comptroller of the Currency (OCC) announced that it would begin accepting applications for a special purpose national bank charter, commonly known as the Fintech Charter. The OCC is the first prudential banking regulator to offer a pathway for non-banking firms to enter the banking system. The Fintech Charter is a national bank charter that is available to qualifying companies engaged in a limited range of banking activities, specifically providing payment services and/or lending money, but not taking deposits. Like traditionally-chartered national banks, companies that apply and receive a Fintech Charter would be subject to the statutes, regulations, guidance and federal supervision that apply to all national banks, with some exceptions and tailoring based on the company's business model. There have not yet been any applications for a Fintech Charter,[1] which is likely because of the uncertainty caused by pending litigation.

[1] As of December 5, 2019.

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Since the OCC released its initial proposal for a Fintech Charter in December 2016, certain stakeholders have voiced significant opposition. The New York Department of Financial Services and the Conference of State Bank Supervisors have each sued the OCC to stop it from issuing Fintech Charters, arguing that the OCC lacks statutory authority to charter special-purpose national banks that do not accept deposits. In October 2019, the District Court for the Southern District of New York ruled in favor of the New York Department of Financial Services and held that the National Bank Act "unambiguously requires that, absent a statutory provision to the contrary, only depository institutions are eligible to receive national bank charters from [the] OCC."[2] The OCC appealed the decision to the U.S. Court of Appeals for the Second Circuit in 2020.[3] The District Court for the District of Columbia dismissed the lawsuit brought by the Conference of State Bank Supervisors in September 2019 for a lack of standing because the OCC has not yet granted a Fintech Charter.[4] This litigation seems likely to drag on for years, and the resulting uncertainty has clearly dampened investor enthusiasm for the Fintech Charter.

There is also uncertainty about the Federal Reserve's response to the Fintech Charter. National banks are required to be members of the Federal Reserve System,[5] but the Federal Reserve has refused, for almost four years, to clarify whether companies that receive an OCC Fintech bank charter will be given a Master Account at a Federal Reserve Bank, which grants direct access to the Federal Reserve's payment system.[6] As discussed in further detail in the background materials, access to the Federal Reserve's payment system will be crucial for certain business models so as to realize the full potential of a national charter.

The recent developments in the litigation against the OCC have increased pressure on Congress to act. Former Comptroller Thomas Curry, for example, has called on Congress to "consider a bipartisan legislative solution that builds on the home-and-host state framework established under [the law governing interstate banking]" because "we cannot wait one, two or more years for the federal courts to decide whether the OCC [Fintech Charter] is a means to offer a national option for Fintechs, while other countries develop competing and streamlined regulatory frameworks that are conducive to innovation."[7]

The Senate Banking Committee is considering legislation that would make abundantly clear that the OCC has the authority to issue a special purpose national bank charter for new entrants and clarify that entities that receive such a charter would be eligible for membership in the Federal Reserve System. The Committee would like to limit the legislation to these two issues and is not intending to change any other feature of the OCC's Fintech Charter. The Chairman of the Senate Banking Committee has signaled support for the bill. If passed, the Committee's goal would be to moot the ongoing litigation about the OCC's authority and reduce uncertainty in the sector. The upcoming hearing aims to assist the Committee in deciding whether it wants to introduce this bill.

In preparation for the hearing, the Senators would like you to brief them on the policy and political considerations surrounding the Fintech Charter. As you know, the Senators are new to the Committee,

[2] *Lacewell v. Off. of the Comp. of the Currency*, No. 18 Civ. 8377, 2019 U.S. Dist. LEXIS 182934, at *4 (S.D.N.Y. Oct. 21, 2019).
[3] For arguments in support of the OCC's appeal, *see Brief of David Zaring,* *Lacewell v. Off. of the Comp. of the Currency*, No. 19-4271 (Apr. 30, 2020).
[4] *Conf. of State Bank Supervisors v. Off. of the Comp. of the Currency*, No. 18-cv-24492019, U.S. Dist. LEXIS 149531 (D.D.C. Sep. 3, 2019).
[5] 12 U.S.C. § 282.
[6] Rachel Witkowski, *Fed Will Have the Say on Key Parts of OCC's Fintech Charter*, AM. BANKER (Sep. 18, 2018), https://www.americanbanker.com/news/fed-will-have-the-say-on-key-parts-of-occs-Fintech-charter. There is currently an open question regarding the Federal Reserve's discretion, or lack thereof, to grant direct access to the payments system for chartered depository institutions. *See* Michael S. Derby, *Bank Sues New York Fed Over Lack of Account*, WALL ST. J (Sep. 5, 2018), https://www.wsj.com/articles/bank-sues-new-york-fed-over-lack-of-account-1536185523.
[7] Thomas Curry, *Congress Can Work Around Court's Nixing of OCC Fintech Charter*, AM. BANKER (Nov. 18, 2019), https://www.americanbanker.com/opinion/congress-can-work-around-courts-nixing-of-occ-Fintech-charter.

and Senator Smith (R) is up for re-election in 2020. In the interest of time, the Senators are requesting to be briefed together. A staff member from the Federal Reserve and a representative from the New York Department of Financial Services will also be briefing the Senators on their respective points of view. You need not concern yourself with legal questions surrounding the OCC's authority to grant such a charter, which would be resolved with the passage of the legislation. Instead, the Senators want to know whether they should take a position on the legislation and, if so, whether they should support or oppose it.

If the legislation passes, companies are much more likely to proceed with an application for a special-purpose national bank charter knowing that much of the legal uncertainty has been resolved. As discussed in further detail below, the Fintech Charter could be extremely valuable to various business models that would now be more inclined to become a chartered national bank.

This memorandum offers additional background on the Fintech Charter and related issues. Also included are a number of appendices with additional items that may be helpful in your analysis. The specific questions to be addressed are listed at the end of the memorandum.

What is the OCC's Fintech Charter?

The leading textbook on Financial Regulation describes the traditional bank charter as follows:

> A bank needs a charter issued by a government authority before it can start taking deposits and making loans. The chartering process for a bank and a corporation are radically different. Anyone with access to the Internet and a credit card can fill out a few forms to incorporate a general-purpose corporation and begin business almost overnight. No state authority with discretionary authority to grant or deny the charter examines the moral character, the qualifications and experience of the investors, or whether the community needs the product offered by the new company. On the contrary, it is considered a virtue of the American capitalist system that two guys in a dorm room or a garage with no experience and an idea about a novel product can start a company.
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> The process could not be more different for those seeking to charter a new bank and there is no guarantee that the application will be approved. The Federal Reserve Board's website describes the process:
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> "Starting a bank involves a long organization process that could take a year or more and permission from at least two regulatory authorities. Extensive information about the organizer(s), the business plan, senior management team, finances, capital adequacy, risk management infrastructure, and other relevant factors must be provided to the appropriate authorities."[8,9]

Many Fintech companies that started out as two guys in a garage have now come face-to-face with the bank chartering process and are grappling with the costs and benefits of a bank charter, which vary based on the chartering institution involved. Bank organizers—people wishing to start a bank—have a choice of chartering agencies.

The United States has a dual banking system, which means that banks can be chartered either at the state level by a state banking regulator, or at the federal level by the OCC. The choice of chartering institution is also a choice of the primary regulator. State-chartered banks are regulated primarily by state banking authorities and secondarily by the Federal Deposit Insurance Corporation (FDIC), while national banks are regulated primarily by the OCC. Institutions that are successfully approved for the OCC's Fintech Charter would be regulated primarily by the OCC.

The OCC's Fintech Charter began as a white paper titled *Supporting Responsible Innovation in the Federal Banking System* released in March 2016. After months of innovation initiatives, the OCC proposed a special purpose national bank charter in December 2016. Under that proposal, charter holders would be required to engage in at least one of the three core banking functions—receiving deposits, paying checks[10] or making loans. Following the end of the comment period on the proposed charter in January 2017, the final policy narrowed the scope of the charter to exclude deposit-taking institutions, thus removing the need for FDIC insurance. Excluding deposit-taking institutions also meant that a firm with a Fintech Charter

[8] *See How Can I Start a Bank?*, FED. RESERVE (last updated Aug. 2, 2013).
[9] BARR, JACKSON & THAYER, FINANCIAL REGULATION: LAW AND POLICY 165 (2nd ed. 2018).
[10] The OCC considers issuing debit cards or engaging in other means of facilitating payments electronically the modern equivalent of paying checks. *See* Office of the Comptroller of the Currency, *Exploring Special Purpose National Bank Charters for Fintech Companies* 4 (Dec. 2016), https://www.occ.gov/topics/responsible-innovation/comments/special-purpose-national-bank-charters-for-Fintech.pdf.

would fall outside the definition of a "bank" under the Bank Holding Company Act (BHCA) and could be owned by a company that is also engaged in commercial or nonfinancial ventures. The BHCA, among other things, imposes significant restrictions on the types of activities that entities that control, are controlled by or share common control with a bank can engage in and subjects them to supervision by the Federal Reserve.

Applying the BHCA to Fintech companies could mean that if Amazon opens a traditional deposit-taking bank, for example, all of Amazon's activities, including those that have nothing to do with banking, such as Prime grocery services and Prime media content, would become subject to the activities restrictions of the BHCA and fall within the supervision of the Federal Reserve.

An alternative to a Fintech Charter might be an Industrial Loan Company (ILC) charter, which is issued in certain states, most commonly Utah. ILCs with assets over $100 million may accept certain forms of deposits and therefore must obtain FDIC insurance. ILCs are also exempt from the definition of a "bank" under the BHCA. In recent years, there have been attempts to block the use of the ILC charter, as described in the Financial Regulation textbook, as follows:

> The popularity of the ILC charter began to dim in 2006 when the FDIC imposed a moratorium on deposit insurance for new ILCs. The moratorium was spurred by Walmart's attempt to form a Utah-chartered ILC, which generated widespread opposition from community bankers, the Federal Reserve Board, labor unions, retail stores and members of Congress. The primary activity of Walmart's proposed ILC was to "act as a sponsor for the processing and settlement of credit card payments, debit card payments, and check payments made by customers at Walmart stores."[11] The public outcry that resulted was unprecedented, especially considering that Target had been previously granted an ILC charter. In addition to the moratorium, many non-bank financial ILCs failed or were converted to bank holding companies during the Financial Crisis. As a result, by early 2017, only 25 ILCs remained, controlling a total of $152.4 billion in assets.
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> Nonetheless, the ILC charter still exists, together with its extremely valuable exception from the BHCA. Attempts to eradicate the charter as part of the 2010 Dodd-Frank Act failed. Congress instead imposed a three-year moratorium on the granting of any new FDIC insurance for ILCs, essentially preventing any new charters. The FDIC moratorium expired on July 21, 2013, and no new charters have been granted since 2009. The FDIC's informal moratorium on granting deposit insurance to new ILC charters has ended, with both FDIC staff and the Chairman Jelena McWilliams making statements that the FDIC will now consider such applications.[12]

As a state-chartered, FDIC-insured institution, an ILC provides many of the benefits of a national bank, as described in Section II, including preemption of state licensing and usury laws and access to the Federal Reserve's payments system. The existence of the ILC charter as a potential alternative to the OCC's Fintech Charter may diminish the urgency to resolve the lingering uncertainties around the OCC's Fintech Charter. In 2020, the FDIC granted deposit insurance to two proposed ILCs, Nelnet Bank and Square Financial

[11] Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN. L. REV. 1539, 1541–42, 1544 (2007).
[12] BARR, JACKSON & TAHYAR, *supra* note 8, at 178.

Services, Inc., both Fintechs. These were the first such approvals by the FDIC since before the Financial Crisis, however.

Why Would a New Entrant Want a Fintech Charter from the OCC?

While a bank charter comes with a host of regulatory responsibilities—including frequent examination and reporting requirements as well as minimum capital requirements—it also provides a suite of benefits to institutions that want to engage in certain business lines. Because the OCC's Fintech Charter does not permit deposit-taking, the benefits of the charter will mainly accrue to institutions that engage in the business of "paying checks" or "lending money." The OCC has taken a broad interpretation of what it considers the business of "paying checks" or "lending money." The OCC's 2016 Charter Proposal stated, "discounting notes, purchasing bank-permissible debt securities, engaging in lease-financing transactions, and making loans are forms of lending money. Similarly, issuing debit cards or engaging in other means of facilitating payments electronically are the modern equivalent of paying checks."[13]

For non-bank institutions engaged in lending money, the key benefits of a national bank charter are the preemption of state usury laws, which limit how much lenders can charge in interest. National banks engaged in lending activities—a core banking function—are entitled to federal preemption of state usury laws so that a national bank is permitted to export the maximum interest rate allowed in the state where the bank is located and make loans in other states without regard to the usury laws of those states.[14] The power to use one state's interest and usury provisions for interstate lending activities are commonly referred to as the Exportation Doctrine. Most national banks engaged in nationwide lending choose a state with no or very liberal usury limits as the locus for such activities.

> A firm receiving a special purpose charter, accordingly, would be similarly entitled to take advantage of the Exportation Doctrine. Since many state laws provide that a usurious loan is void, the benefits of the Exportation Doctrine are very important. Without such benefits, stand-alone nonbank lenders must comply with the usury laws in each state in which they provide loans to avoid such loans being deemed void under state law. This consequence has been especially concerning in light of the uncertainty of the bank partnership, or "rent-a-charter," model raised by recent court decisions such as *CashCall* and *Madden*.[15,16]

The key benefits of a national bank charter for institutions engaged in the business of facilitating payments are the ability to preempt state money transmitter license laws and the ability to directly access the

[13] Office of the Comptroller of the Currency, *Exploring Special Purpose National Bank Charters for Fintech Companies* 4 (Dec. 2016), https://www.occ.gov/topics/responsible-innovation/comments/special-purpose-national-bank-charters-for-Fintech.pdf.
[14] 12 U.S.C. § 85; 12 C.F.R. §§ 7.4001, 7.4008.
[15] Davis Polk & Wardwell LLP, *Beyond Fintech: The OCC's Special Purpose National Bank Charter* 3 (Dec. 9, 2016), https://www.davispolk.com/files/2016-12-9_occs_special_purpose_national_bank_charter.pdf.
[16] *See CashCall v. Morrisey*, No. 12-1274 (W. Va. 2014); *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015). Under the "rent-a-charter" model, a marketplace lender typically enters into a contractual arrangement with an existing chartered bank pursuant to which the bank initially funds the loan but the marketplace lender purchases the loan from the bank at the time of or shortly after origination. The marketplace lender may also assume loan servicing, collection and other administrative functions of the original funding bank. Both *CashCall* and *Madden* called into question the viability of the rent-a-charter model by holding that the original funding bank must retain a predominant economic interest in the loan in order for preemption of state usury law to apply to the nonbank lender. While cases in other states have upheld the rent-a-charter model, the differences across jurisdictions and resulting regulatory uncertainty create new operational challenges for marketplace lenders. *See, e.g.*, *Sawyer v. Bill Me Later*, Inc., 23 F. Supp.3d 1359 (D. Utah 2014). The proper use of the special purpose charter and the ongoing involvement of a firm with a special purpose charter in owning and servicing the loans generated should resolve the true lender issues highlighted in *CashCall* and *Madden*.

Federal Reserve's payment system. [17] These benefits were explained in a Davis Polk & Wardwell LLP memorandum as follows:

> National banks are entitled to federal preemption of state laws and regulations, including licensing requirements, when they conflict with a national bank's power to engage in a broad range of payment services.[18] National banks are able to avoid state-level money transmitter licensing requirements and, in turn, the expensive and time-consuming state-by-state money transmitter licensing process, in order to engage in such activities.[19]
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> Currently, virtually every state has some form of licensing requirement for businesses engaged in the transmission of money.[20] These laws, while certainly covering traditional money transmitters such as Western Union and MoneyGram, may also catch nonbank firms engaged in payment services — including online, mobile payment and virtual currency providers — subjecting them to an array of regulatory and compliance issues. The scope of activities considered to be money transmission varies by state,[21] Nonbank firms with multistate operations must comply with varying standards and complex licensing and registration requirements that typically include financial requirements, audits, bonding, investment limitations, and the like.
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> In contrast, firms with special-purpose charters, like full-service national banks, could avoid state-level money transmitter licensing requirements, allowing them to avoid the costly state-by-state licensing regime and potentially significantly reducing their compliance costs and complexity. Such firms would still be required to comply with federal anti-money laundering laws. . . . [Firms] that engage in activities subject to a "state consumer financial law"[22] would generally remain subject to such laws, unless the explicit grounds for preemption under the Dodd-Frank Act were met.[23] Examples of state consumer protection laws that would generally apply include state laws on anti-discrimination and fair lending. Moreover, the OCC explicitly states in the Charter Proposal that state laws aimed at unfair or deceptive treatment of customers also apply to federally chartered banks.[24]

As national banks, firms with special-purpose charters will be required to be members of the Federal Reserve System pursuant to the Federal Reserve Act and will be subject to direct oversight as member

[17] Because this case study has been developed for use in a classroom setting that will have already discussed marketplace lending and preemption, consideration of lending-focused Fintechs is being kept to a minimum to allow focus instead on the payment applications of the OCC's Fintech Charter.

[18] See OCC Preemption Final Rule, 76 Fed. Reg. 43,549, 43,555 (July 21, 2011). The OCC has taken the view that payment services are permissible activities for national banks as incidental to the business of banking. See generally, Office of the Comptroller of the Currency, Activities Permissible for a National Bank, Cumulative (April 2012).

[19] State-level licensing requirements that prevent, or significantly interfere or conflict with the exercise by a national bank of its federally-granted powers, including the power to engage in payment services, are preempted in accordance with the legal standard established in Barnett Bank v. Nelson, 517 U.S. 25 (1996). See OCC Preemption Final Rule, 76 Fed. Reg. 43,549, 43,556 (July 21, 2011).

[20] See, e.g., N.Y. Code, Banking 13-B; Tex. Fin. Code § 151; Ca. Fin. Code § 2000; Fla. Stat. § 560.

[21] See, e.g., Md. Code Ann., Fin. Inst. § 12-401 ("Money transmission" includes the business of selling or issuing payment instruments or stored value devices, or receiving money or monetary value, for transmission to a location within or outside the United States by any means, including electronically or through the Internet, bill payer services, accelerated mortgage payment services, and any informal money transfer system engaged in as a business for, or network of persons who engage as a business in, facilitating the transfer of money outside conventional financial institutions to a location within or outside the United States.)

[22] "State consumer financial law" is generally defined as any state law that regulates any "financial transaction [or related] account . . . with respect to a consumer." See 12 U.S.C. § 25b(a)(2).

[23] 12 U.S.C. § 25(b)(1). The Dodd-Frank Act provided that state consumer financial laws are preempted only if the application of the law would have a discriminatory effect on national banks (compared to state banks), the OCC determines on a case-by-case basis that the law "prevents or significantly interferes" with the exercise by the national bank of its powers, or the state law is preempted by another federal law. Id.

[24] Davis Polk & Wardwell LLP, supra note 11, at 3.

banks by the Federal Reserve Board.[25] Member banks, and all insured depository institutions, have access to the Federal Reserve discount window and other Federal Reserve services, including the ability to create a Master Account at the Federal Reserve.

The Federal Reserve allows member banks, other depository institutions, U.S. branches of foreign banks and certain U.S. government entities to create Master Accounts with their local Federal Reserve Bank.[26] A Master Account allows a financial institution to settle transactions with other financial institutions directly on the books of the Federal Reserve. If a JPMorgan Chase customer, for example, sends money to a Bank of America customer, the two banks can exchange funds via their Master Accounts at the Federal Reserve. A Master Account provides the ability to "accept and clear customer checks drawn on other banks; . . . to issue checks or otherwise make payments other than in cash; and . . . to transfer funds to other banks."[27] Without a Master Account, a bank would be nothing more than a "network of cash vaults that would provide customers with the ability to transact business only with other customers of the bank, with no ability to transact business outside of the . . . bank network."[28]

Institutions that are not eligible for a Master Account, or that choose not to create one, can only access the Federal Reserve's payments system indirectly, through an intermediary relationship with a bank that does have a Master Account, called a correspondent bank. PayPal, for example, contracts with a bank for payment services. Where both the payor and recipient are PayPal customers and the funds reside in PayPal accounts, funds can be transferred easily within the private sector by transferring the funds from one PayPal account to another.[29] However, when money is transferred between PayPal and non-PayPal accounts, such as when a customer makes a payment that requires pulling the funds out of their checking account, clearing and settlement requires a mix of the private sector and Federal Reserve involvement. Correspondent banks, of course, charge a fee for providing clearing and settlement services. Payment-focused Fintechs that can obtain their own Master Accounts—instead of having to go through a correspondent bank—can avoid this fee.

A national bank charter would also allow an entity to avoid paying interchange fees, which are the fees charged to merchants when customers pay using a debit or credit card. Interchange fees are further described in the Financial Regulation textbook:

> Credit and debit card networks are highly concentrated. In 2017, Visa's total purchase volume accounted for 53% of the credit card market, followed by MasterCard at 22% and American Express at 21%, with Discover accounting for the remaining 4% share. When you swipe your credit or debit card at a merchant terminal, your bank (the issuer) debits your account and sends the transaction to the card network, which then forwards the transaction information to the merchant's bank (the acquirer). The acquirer then credits the merchant's account. The acquirer does not credit the merchant the full amount of the retail transaction because the issuer charges the acquirer an interchange fee, and the acquirer deducts those fees, along with the acquirer's own fees, from the amount credited to the merchant. That amount is

[25] For the purposes of this case study, we are assuming that membership in the Federal Reserve System would be granted to firms with an OCC Fintech Charter.
[26] FED. RESERVE BANKS, OP. CIRCULAR 1: ACCOUNT RELATIONSHIPS § 2.2 (Feb. 1, 2013) https://www.frbservices.org/assets/resources/rules-regulations/020113-operating-circular-1.pdf.
[27] Level 4 Ventures, Inc. et al, *State-backed Financial Institution (Public Bank) for the State of California Servicing the Cannabis Industry Feasibility Study 2018* 17 (Dec. 6, 2018).
[28] *Id.*
[29] Richard J. Sullivan, *The Federal Reserve's Reduced Role in Retail Payments: Implications for Efficiency and Risk*, FED. RESERVE BANK OF KANSAS CITY 86–87 (2012), https://www.kansascityfed.org/publicat/econrev/pdf/12q3Sullivan.pdf.

known as the merchant discount. Interchange fees are costs to merchants and revenue to card issuers. Issuers and acquirers also pay a switch fee to the network.[30]

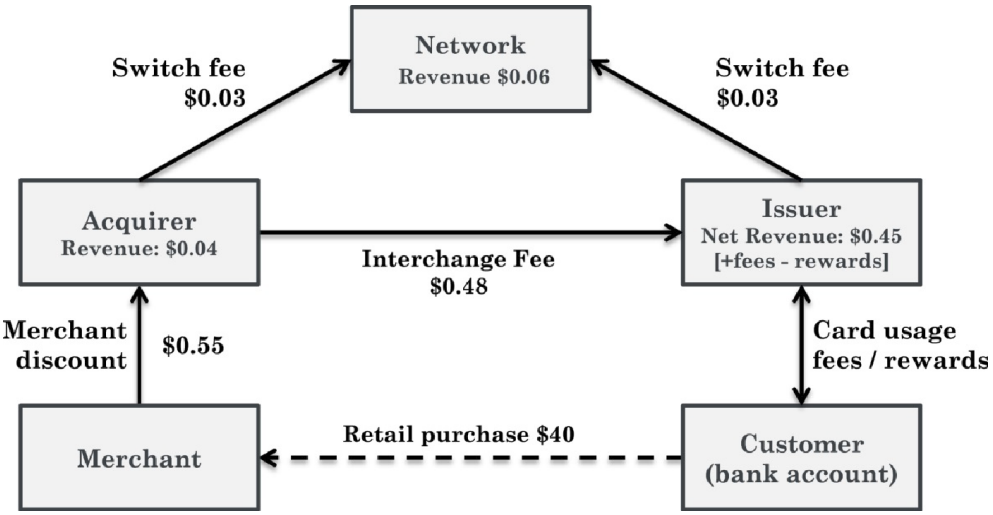

Figure 1 Overview of Interchange Fees[31]

For a large retailer like Walmart or Amazon, avoiding even 55 cents per transaction can significantly boost profits when multiplied over billions of transactions. If a retailer opens a bank, it can assume the role of the acquirer—at the very least—and avoid having to pay a fee to its bank. More importantly, if it can issue its own payment products and convince customers to use them, it can avoid almost the entirety of the interchange fee, in addition to receiving issuer fees when customers use its payment products at other retailers.

In addition to preemption and payment processing benefits, companies may find that a Fintech Charter gives them options to enhance business lines or generate new streams of revenue. Institutions that have access to large amounts of consumer data could leverage consumer information to generate entirely new models of the banking relationship. Given the wealth of customer data that Amazon has, for example, it could develop unique lending algorithms that give it a competitive advantage over traditional banks who must rely on customer-provided data or credit bureau reports.

> PayPal Holdings Inc. has extended more than $6 billion in small-business loans since 2013, using data collected by processing payments for internet retailers. Over the past seven years, independent merchants that sell goods on Amazon have borrowed more than $3 billion from the e-commerce giant, which approves loans based on sellers' historical volumes, Amazon reviews and other factors."[32]

A Google Bank account could integrate seamlessly into a user's Google Calendar and Gmail to create reminders when bills are due and make payments automatically. It could use predictive technologies and artificial intelligence to monitor personal budgets and send alerts when a user has spent too much on dinner with friends.

[30] BARR, JACKSON & THAYER, *supra* note 5, at 842–43.
[31] Benjamin S. Kay et al., *Bank Profitability and Debit Card Interchange Regulation: Bank Responses to the Durbin Amendment* 7 (Divisions of Research & Statistics and Monetary Affairs, Fed. Reserve Bd. Fin. and Econ. Discussion Series No. 2014-77, 2014).
[32] Peter Rudegeair, *A $150,000 Small Business Loan—From an App*, WALL ST. J (Dec. 28, 2018), https://www.wsj.com/articles/a-150-000-small-business-loanfrom-an-app-11546002022.

What are Some Concerns about the Fintech Charter?

When the OCC initially proposed a Fintech Charter in 2016, the comments received were mixed. Some commenters strongly supported the proposal and encouraged the OCC to provide further flexibility under the charter framework to ensure that certain types of new payment services would be within the scope of the Charter and that the regulatory requirements applicable to firms with a Fintech Charter, such as capital and liquidity standards, would be commensurate with the nature and size of an institution's business. Comment letters in this category were largely submitted by Fintech firms and trade associations representing Fintechs or other non-bank institutions.[33]

Commenters representing a mix of existing banking organizations, such as Fintech firms and consumer advocacy organizations, supported the special purpose charter so long as companies with a Fintech Charter were subject to the same rules and requirements that applied to all national banks.[34]

Many commenters opposed the OCC's proposal based on their view that the Charter would create an uneven playing field between insured banks and uninsured special purpose national banks, harm consumers, and/or that the OCC lacked the legal authority to authorize the special purpose charter. This opposition mainly came from state regulators and attorneys general, consumer advocacy organizations, banking organizations and trade associations representing those groups.[35]

Commenters opposing the proposal expressed concern that the special purpose charter would enable non-depository institutions to enjoy the benefits of a national bank charter without being subject to the same requirements as deposit-taking institutions. Although the OCC stated in its charter framework that obligations similar to those imposed under the Community Reinvestment Act, and federal and state consumer protection laws would still apply to firms with a Fintech Charter, several commenters argued that the special purpose charter would allow Fintech companies to evade financial inclusion obligations and consumer protection requirements.[36] Moreover, a few commenters believed that the ability of a special purpose charter holder to operate outside the scope of the BHCA, thus enabling the holder to mix banking and commerce, is contrary to the policies embedded in the BHCA and the National Bank Act.

Commenters also criticized the special purpose charter as a potential avenue for firms with a Fintech Charter to avoid having to comply with federal and state consumer protection laws. For example, the Conference of State Bank Supervisors (CSBS) argued that firms with a Fintech Charter would not be subject to the same scope of federal consumer financial laws as insured depository institutions given the more limited supervision the CFPB has over non-depository institutions. Consumer advocacy organizations and state attorneys general also emphasized that the special purpose charter would allow institutions to preempt state and local consumer protection laws. In the CSBS's lawsuit against the OCC over the Fintech Charter, the CSBS states:

> [S]tate laws, which face a clear threat of preemption under the OCC's unauthorized nonbank charter plan, provide vital protections to the economies, communities and citizens of every state. As recent history has shown, however, broad preemption of state law with respect to nationally

[33] *See, e.g.*, Lending Club, *Comment Letter on OCC White Paper on Exploring Special Purpose National Bank Charters for Fintech Companies* (Jan. 17, 2017), https://www.occ.gov/topics/responsible-innovation/comments/comment-lending-club.pdf.
[34] *See, e.g.*, The Clearing House et al., *Comment Letter on OCC White Paper on Exploring Special Purpose National Bank Charters for Fintech Companies* (Jan. 17, 2017), https://www.occ.gov/topics/responsible-innovation/comments/comment-clearing-house-et-al.pdf.
[35] *See, e.g.*, Nat'l Cons. Law Ctr., *Comment Letter on OCC White Paper on Exploring Special Purpose National Bank Charters for Fintech Companies* (Jan. 17, 2017), https://www.occ.gov/topics/responsible-innovation/comments/comment-nclc-et-al.pdf.
[36] *Id.*

> chartered banks is not good public policy. State government officials have unique expertise in the banking practices and market conditions in their communities, which makes them uniquely situated to recognize and act upon consumer financial protection issues. Due to their proximity to the consumers and the communities they are charged with protecting, state regulators are also uniquely locally accountable relative to centralized federal agencies."[37]

How are Other Countries Approaching Fintech?

The nature of the U.S. dual-banking system has led to a fragmented and patchwork response to emerging trends like Fintech. Other countries have responded to new business models in the financial sector in vastly different ways. "International and US regulators approach emerging business practices, products, and services in three distinct but complementary ways: creating outreach programs to bring together regulators and market participants to clarify how innovation fits into the existing regulatory framework; changing the regulatory framework to encompass new products, practices, and providers; or suspending regulatory barriers to encourage innovation."[38]

The United Kingdom is one example of a country that has applied the outreach model to Fintech. The UK Financial Conduct Authority (FCA) "issued a call for input on the development of a financial innovation hub, which included communication with stakeholders as a specific agency objective."[39] "In October 2014, the FCA launched Project Innovate and the Innovation Hub to foster competition and growth in financial services by helping firms with new products understand and navigate the regulatory framework and apply for a business license. . . . The project has also created "regulatory surgery" sessions to allow firms time to address specific regulatory issues, questions, or concerns."[40]

The UK also embraced a "sandbox" model, which allows "companies to experiment with products in a modified regulatory framework, either in a controlled testing environment or through regulatory relief whereby agencies suspend certain regulations for novel business practices. This allows regulators to observe a product's effect on consumers and engage with new market participants regarding products that do not fit neatly into the existing regulatory structure."[41] This regulatory approach appears to be paying off in some ways, for example, in the first eight months of 2019, London had attracted $2.1 billion in fundraising deals in 2019, $200 million ahead of New York in total deal value.[42]

China, by contrast, took a completely different approach to financial technology and has, likewise, seen a booming Fintech sector. As of early 2018, out of 27 Fintech startups with valuations exceeding $1 billion, nine are Chinese.[43] "In 2016, Chinese consumers spent approximately $22.8 trillion (RMB 157.55 trillion) through mobile payment platforms, far exceeding the volume of transactions in the United States ($112 billion). Over 90 percent of that sum stemmed from mobile payment apps that belong to China's two

[37] Complaint at 7, *Conf. of State Bank Supervisors v. Off. of Comp. of Currency*, 313 F. Supp. 3d 285 (D.D.C. 2018).
[38] Pew Trusts, *How Can Regulators Promote Financial Innovation While Also Protecting Consumers?* (Aug. 2, 2018), https://www.pewtrusts.org/research-and-analysis/reports/2018/08/02/how-can-regulators-promote-financial-innovation-while-also-protecting-consumers.
[39] *Id.*
[40] *Id.*
[41] *Id.*
[42] Ryan Browne, *London Just Overtook New York for Fintech Investment, Research Shows,* CNBC (Sep. 22, 2019), https://www.cnbc.com/2019/09/22/london-just-overtook-new-york-for-Fintech-investment-research-shows.html.
[43] Wei Wang & David Dollar, *What's Happening With China's Fintech Industry?*, BROOKINGS (Feb. 8, 2018), https://www.brookings.edu/blog/order-from-chaos/2018/02/08/whats-happening-with-chinas-Fintech-industry/

biggest tech conglomerates: Alibaba's Alipay (54 percent) and Tencent's TenPay (37 percent)."[44] Much of this growth has been attributed to a combination of: "(1) high national Internet and mobile penetration, (2) a large e-commerce system with domestic Internet companies focused on payments, (3) relatively unsophisticated incumbent consumer banking, and (4) accommodative regulations."[45]

The Chinese regulators took a relatively arms-length approach to Fintech, allowing the tremendous scale we see now.[46] "Under a relatively lax regulatory environment over the past decade, a number of nonfinancial Chinese firms have waded into multiple financial sectors and achieved breakneck expansion because they were not subject to rules applied to traditional institutions like banks."[47] While this has started to change, China's regulations remain "relatively less onerous" than those in markets such as Singapore and the UK.[48]

Your Assignment from the Senators

Your briefing is intended to help the Senators decide whether or not to support the proposed bill. Staff from the Federal Reserve will be presenting the views of the Federal Reserve, and whether the Federal Reserve would support the proposed bill. Staff from the New York Department of Financial Services (DFS) present the views of the DFS.

The Senators have allocated 15 minutes each for the Federal Reserve and the DFS. You, as Senate staffers, have been allocated a combined 45 minutes. You can present together or separately, as you wish. You should coordinate between yourselves and with the representatives from the Federal Reserve and the DFS on which topics you wish to present, and in what order. As you know, the Senators' time is extremely limited, and they expect you to be succinct but thorough.

The Senators expect you, as Senate staffers, to brief them on the following issues and, in particular, to be prepared to brief on the political dimensions of the below issues for each party:

1. **Competition:** The Senators would like to know the potential impact of the OCC Fintech Charter on competition in the financial sector. Community banks are vocal constituents in their states, as are large banks. Google, Amazon and other large tech companies are also, of course, influential. Keep in mind that competition from new entrants may not be equally felt across the banking sector and community banks and large banks may face different challenges and opportunities in responding to competition from new entrants. How will various constituents think about the Fintech Charter? How should the Senators craft their positions on the legislation given the competing interests of stakeholders, both within the banking sector and between the banking and technology sectors?

[44] *Id.*
[45] Citi GPS: Global Perspectives and Solutions, *Digital Disruption: How Fintech is Forcing Banking to a Tipping Point* 9 (Mar. 2016), https://ir.citi.com/D%2F5GCKN6uoSvhbvCmUDS05SYsRaDvAykPjb5subGr7f1JMe8w2oX1bqpFm6RdjSRSpGzSaXhyXY%3D.
[46] EY, *UK Fintech: On the Cutting Edge* 16, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/502995/UK_Fintech_-_On_the_cutting_edge_-_Full_Report.pdf.
[47] Stella Yifan Xie & Chao Deng, *China to Tighten Rules on Five Financial Giants*, WALL ST. J. (Nov. 3, 2018), https://www.wsj.com/articles/china-to-tighten-rules-on-five-financial-giants-1541246489.
[48] DBS & EY, *The Rise of Fintech in China* 27 (Nov. 2016), https://www.ey.com/Publication/vwLUAssets/ey-the-rise-of-Fintech-in-china/$FILE/ey-the-rise-of-Fintech-in-china.pdf.

2. **Innovation for consumers:** Fintechs promise a greatly enhanced banking experience for consumers. How would granting a federal charter to Fintech firms impact consumers? What is the potential impact on the speed of innovation? What is the potential for the Fintech Charter to increase access to financial services for the unbanked and underbanked?

3. **Global competition:** The United Kingdom and China are two examples of different models of regulatory engagement around Fintech, and the United States risks falling behind in the global race for Fintech investment. What light can the differing experiences of the UK and China shed on the approach the US regulators should take towards Fintech domestically?

4. **Consumer protection and the CRA:** As discussed, some of the critics of the OCC's Fintech Charter are concerned that the charter will be used to evade state consumer-protection laws that may be more stringent than Federal laws. Some have suggested that the DFS and the CSBS are more concerned with protecting their licensing fees and revenues than in consumer protection. Is there any validity to this point of view? How should the Senators approach this issue and how should they balance these concerns against the potential for consumer benefits? Further, because an entity with a Fintech Charter would not take deposits, it would not be subject to the Community Reinvestment Act (CRA) which requires deposit-taking institutions to make investments in low- and moderate-income communities. The CRA, however, has not been significantly reformed since 1977 and is based on a geographic catchment model that links loans to the geographic area in which deposits are gathered. There is an ongoing and highly controversial effort to reform the CRA.[49] How should the Senators deal with these concerns?

5. **Size and concentration concerns:** Some Senators are concerned about the concentration of economic power in a few companies. If Amazon, Facebook or Google obtains a bank charter, are there concerns with a single company having such a large footprint in both commerce and banking? Are there systemic risk concerns? On the other hand, could broadening the financial sector to include non-traditional banks reduce systemic risk?

6. **Political and electoral concerns:** Aside from the policy points above which, of course, have political implications, each Senator has specific political concerns related to fundraising and the nature of their state's constituency. What might these be? How should they impact private discussions the Senators have with the committee chairman and other Senators? How should they impact any public statements the Senators make at the hearing? How, if at all, should the Senators' private and public postures differ?

The Senators expect staff from the Federal Reserve to describe why the Federal Reserve has not been able to determine, after four years, whether and under what conditions it would permit a financial institution with a Fintech Charter to obtain a Master Account. What are the advantages and disadvantages of allowing access to a Master Account from the perspective of the Federal Reserve? Why is the Federal Reserve unable to clarify its view on this issue?

[49] *See* Rachel Witkowski, *Cheat Sheet: 5 Pressure Points in CRA Reform Debate*, AM. BANKER (Aug. 30, 2018), https://www.americanbanker.com/list/cheat-sheet-5-pressure-points-in-cra-reform-debate.

The Senators expect staff from the DFS to lay out in full the concerns of the DFS and the Conference of State Banking Supervisors against the Fintech Charter. Since the bill being considered would resolve the uncertainty surrounding the OCC's authority to issue the Fintech Charter, their briefing is expected to focus on why they are against the concept of the Fintech Charter and not on the OCC's authority to issue one.

Appendices

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2. Lacewell v. Office of the Comptroller of the Currency, No. 18 Civ. 8377, 2019 U.S. Dist. LEXIS 182934, at *4 (S.D.N.Y. Oct. 21, 2019). https://www.law360.com/dockets/download/5db0b9ef3afb12094ab4183f?doc_url=https%3A%2F%2Fecf.nysd.uscourts.gov%2Fdoc1%2F127125725167&label=Case+Filing

3. Statement, Linda A. Lacewell, Statement on Court Ruling on OCC's Fintech Charter (Oct. 22, 2019). https://www.dfs.ny.gov/reports_and_publications/statements_comments/2019/st1910221

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