MEMORANDUM

FROM: Office of the Comptroller of the Currency

TO: Junior OCC Lawyer

RE: OCC's Legal Authority to Offer National Bank Charters to FinTech Companies

DATE: May 2017

Thanks for clearing your schedule to work on this matter. The Comptroller would like you to get yourself prepared to brief the Comptroller on the OCC's legal authority to grant special purpose national bank ("SPNB") charters to non-depository FinTech firms.

Since you recently started at the OCC, I'd like to give you some background on this issue. In late 2016, the OCC announced that it was exploring whether to offer a charter to financial technology ("FinTech") companies.[1] In response to this announcement, nearly a dozen financial industry groups wrote comment letters challenging the OCC's legal authority to offer national bank charters to FinTech companies that did not accept deposits.[2] On April 26, 2017, the Conference of State Bank Supervisors ("CSBS") filed suit against the OCC seeking to enjoin the OCC from granting national bank charters to non-depository FinTech companies , arguing that granting such charters is in excess of the OCC's statutory authority.[3]

The CSBS lawsuit and the critical comment letters primarily focus on a 1985 case from the United States District Court for the Middle District of Florida which held that taking deposits was a necessary element to the definition of the "business of banking."[4] Because the OCC

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1 www.occ.treas.gov/topics/bank-operations/innovation/comments/special-purpose-national-bank-charters-for-fintech.pdf [perma.cc/2ZEN-DTBK].

2 www.occ.treas.gov/topics/responsible-innovation/comments/comment-csbs-comment-letter-special-purpose-national-bank-charters-fintech.pdf [perma.cc/ZV8J-KGE9]; www.occ.treas.gov/topics/responsible-innovation/comments/comment-crl.pdf [perma.cc/EC45-VWL6]; www.occ.treas.gov/topics/responsible-innovation/comments/comment-independent-community-bankers.pdf [perma.cc/DN5X-EBSZ]; www.occ.treas.gov/topics/responsible-innovation/comments/comment-nclc-et-al.pdf [perma.cc/3XVU-4KJK]; www.occ.treas.gov/topics/responsible-innovation/comments/comment-americans-for-financial-reform.pdf [perma.cc/C8BF-ZND6].

3 Complaint, *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency*, No. 1:17-cv-00763, 2017 WL 1488257 (D.D.C. Apr. 26, 2017) [hereinafter *CSBS* Complaint].

4 *Independent Bankers Ass'n of America v. Conover*, 1985 U.S. Dist. LEXIS 22529, at *34 -*36 (M.D. Fla. Feb. 15, 1985) (*IBAA v. Conover*).

This case study was prepared by Dylan M. Aluise, Harvard Law School Class of 2017, under the supervision of Professor Howell E. Jackson. This case study is intended for educational purposes only and is not intended to offer legal advice.

can only offer national bank charters to entities that engage in the business of banking, the challengers argue that the OCC lacks the statutory authority to grant national bank charters to non-depository institutions absent an express grant of power from Congress.[5] In addition to the lawsuit and critical comment letters, Senators Sherrod Brown and Jeff Merkley—two Democratic members on the Senate Banking Committee—sent a letter to the Comptroller raising the same question about whether the OCC has the statutory authority to offer SPNB charters to entities that do not take deposits.[6]

The Comptroller has asked you to prepare a brief memo evaluating the allegations that question the OCC's legal authority to grant SPNB charters to non-depository FinTech firms.

Why FinTech Firms are Seeking a National Bank Charter

The FinTech industry, defined by the Department of Commerce as "companies whose line of business combines software and technology to deliver financial services," has been growing over the past decade.[7] These firms have made headway in many areas of the financial services industry, from digital currencies to online and marketplace lending to payment systems. In 2010, investment in the industry was $1.8 billion, has since ballooned to $19 billion in 2015, and it appears as if 2016 will set even higher numbers.[8] Much of this growth has been focused on products targeted for direct use by consumers, including alternative methods of lending money.[9]

Marketplace Lending as a Leading Example of FinTech Companies

Within the FinTech sector, one of the areas garnering the most attention has been the "marketplace lending" or "peer-to-peer lending" space. Certain firms, such as Lending Club and Prosper, have gained prominence by using financial technology to "disrupt" the standard financial intermediary model and provide consumers with new methods of

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[5] www.occ.treas.gov/topics/responsible-innovation/comments/comment-csbs-comment-letter-special-purpose-national-bank-charters-fintech.pdf [perma.cc/ZV8J-KGE9].

[6] www.banking.senate.gov/public/index.cfm/democratic-press-releases?ID=F70DB4BF-5E75-4ED7-B54B-1DE3C844E55F [perma.cc/GMC2-KPZ8]

[7] U.S. DEP'T OF COMMERCE & INT'L TRADE ADMIN, 2016 TOP MARKETS REPORT: FINANCIAL TECHNOLOGY 3 (Aug. 2016), trade.gov/topmarkets/pdf/Financial_Technology_Top_Markets_Report.pdf [perma.cc/5465-N78R].

[8] CITI, DIGITAL DISRUPTION: HOW FINTECH IS FORCING BANKING TO A TIPPING POINT 3 (Mar. 30, 2016), ir.citi.com/SEBhgbdvxes95HWZMmFbjGiU%2FydQ9kbvEbHIruHR%2Fle%2F2Wza4cRvOQUNX8GBWVsV [perma.cc/W7BK-5ATX].

[9] *Id.* (estimating that "70% of [FinTech] investment [has focused] on [companies targeting] the "last mile" of user experience in the consumer space").

borrowing money through alternative lending models. Because of FinTech's growing prominence and increased exposure to American consumers, financial regulators have been closely monitoring the FinTech sector and have been searching for a suitable regulatory framework for these products and services.[10]

Currently, FinTech firms that engage in the lending industry, like marketplace lenders such as Prosper and Lending Club, have two options for operating their businesses.[11] According to the FDIC, these models are 1) become a "direct marketplace lender"; or 2) become a "bank-affiliated marketplace company."[12] Direct marketplace lenders typically must be licensed and registered to lend in each state in which they do business. This requirement subjects the firms not only to regulatory scrutiny by each state's banking or lending regulator, but also to each state's lending laws, usury restrictions, and other consumer protection laws.[13] FinTech firms under this model facilitate all elements of the transaction including collecting borrower applications, assigning credit ratings, advertising the loan request, pairing borrowers with interested investors, originating the loan, and servicing any collected loan payments.[14] At all times, the borrower's repayment obligation remains with the FinTech lender. Industry experts have argued that the licensing procedures and compliance costs required to become a direct marketplace lender in each state are costly and time-consuming, and can "clip the wings of a FinTech company in its early stages."[15]

Alternatively, and more commonly, FinTech firms have opted to become bank-affiliated marketplace companies, in which they partner with a state or national bank and make loans through this cooperative arrangement. In this latter option, the FinTech firm collects borrower applications, assigns the credit grade, and solicits investor interest.[16] The firm then

[10] Regulators such as the United States Department of the Treasury have place increased focus on the impact of marketplace lending. *See, e.g.* U.S. DEP'T OF TREAS., OPPORTUNITIES AND CHALLENGES IN ONLINE MARKETPLACE LENDING (May 10, 2016), www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf [perma.cc/23ZC-LENB].

[11] Fed. Deposit Ins. Corp., *Marketplace Lending*, Supervisory Insights 12-14 (Winter 2015), www.fdic.gov/regulations/examinations/supervisory/insights/siwin15/SI_Winter2015.pdf [perma.cc/NDC9-5TSN] [hereinafter FDIC, *Supervisory Insights*].

[12] *Id.*

[13] Lalita Clozel, *OCC Weighs New Charter for Fintech Firms*, AM. BANKER (May 9, 2016), www.cbaofga.com/uploads/4/1/3/7/41371065/occ_weighs_new_charter_for_fintech_firms_american_banker.pdf [perma.cc/JX27-BLGK].

[14] FDIC, *Supervisory Insights*, *supra* note 11, at 14.

[15] Clozel, OCC Weighs New Charter for Fintech Firms, *supra* note 13.

[16] FDIC, *Supervisory Insights*, *supra* note 11, at 14

refers the completed loan application package to its partner bank, which makes the credit decision and tenders the loan to the borrower.[17] The partner bank typically holds the loan on its books for two to three days before selling it to the FinTech firm, which then has the right to collect money from the borrower. FinTech firms seek out these arrangements with partner banks because state- and federally-chartered banks enjoy preemption from state licensing and usury laws.[18] In what has been described pejoratively as the "rent-a-charter" or "rent-a-bank" arrangement, FinTech firms use this partnership to benefit from the same preemption of state law that banks enjoy.[19]

Regulatory Uncertainty Is a Driving Force for Seeking a Federal Charter

Despite the popularity of the bank partnership model, certain aspects of this arrangement have been called into question in court. In its May 2015 Madden v. Midland Funding, LLC decision, the Second Circuit held that loans in excess of a state's usury rate could only be legally collected by the bank enjoying preemption from state usury laws or by an entity acting on behalf of the bank.[20] Thus, if a bank were to assign all of the interest in a loan to a third-party entity such as a FinTech partner, the assignee would be acting on its own behalf and would be subject to state usury laws.

Further muddying the waters for the bank partnership model has been the growing tendency for courts to use a "true lender" analysis to determine if state laws are preempted in a lending transaction. True lender analysis looks at the substance rather than the form of the transaction in determining the lending entity, rendering the bank's partner the de facto lender if it is deemed to have predominant economic interest.[21] Using the true lender

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[17] *Id.*

[18] *See* 12 U.S.C. §§ 85; 1831d; Milken Institute: Center for Financial Markets, *Re: Public Input on Expanding Access to Credit through Online Marketplace Lending Docket Number: TREAS-DO-2015-0007-0001* 5-11 (Sept. 28, 2015), assets1c.milkeninstitute.org/assets/Publication/Viewpoint/PDF/MICFM-Comment-Letter-TREAS-DO-2015-0007-FINAL.pdf [perma.cc/8VLH-FVUQ].

[19] Brian Knight, Reply Comment: Regulating Fintech: Creating A Regulatory Regime That Enables Innovation While Providing Appropriate Consumer Protection 7 (May 12, 2016), www.occ.gov/topics/responsible-innovation/comments/comments-brian-knight.pdf [perma.cc/LA82-4KEK] [hereinafter Knight Comment Letter]; Nat'l Consumer Law Ctr. et al., Re: Comments on Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective 5-6 (May 31, 2016), www.occ.gov/topics/responsible-innovation/comments/comments-fintech-nclc.pdf [perma.cc/6SJX-XL4W],[hereinafter NCLC Comment Letter].

[20] *Madden v. Midland Funding, LLC*, 786 F.3d 246 (2d Cir. 2015), *cert. denied*, No. 15-610, 2016 U.S. LEXIS 4211 (U.S. June 27, 2016).

[21] Ct. Order Granting Pl. Consumer Fin. Protection Bureau's Mot. For Partial Summ. J., *Consumer Fin. Protection Bureau v. CashCall, Inc. et al.*, No. 15-cv-7522-JFW (C.D. Cal. Aug. 31, 2016), www.mayerbrown.com/files/uploads/Documents/PDFs/2016/August/CFPB-v-CashCall-LRes.pdf.

analysis, federal district courts and some state supreme courts have determined that transactions conducted using a bank partnership model, whereby the loan would quickly revert from the bank to the non-bank partner, were in violation of state licensing and usury laws.[22]

Due to the murky legal status of the bank-partnership model, along with other factors such as being too tied to a single bank partner, FinTech firms have actively sought out other possible business models. A main focus of the industry has been to urge the OCC to use its special purpose chartering provision to extend a national bank charter to FinTech companies. As Steve Carlton, the CEO of FinTech online lender Ascend put it, "if we had a preference today, we would like to be a bank."[23] And, despite the high regulatory barriers imposed by the OCC, as well as the necessary submission to increased regulation and oversight by the federal government, FinTech firms are seeking a federal charter for one big reason—the regulatory umbrella of federal preemption of state rules that comes along with it.[24] As Deputy Comptroller at the OCC Kay Kowitt remarked, FinTech firms "recognize the value of having a uniform set of standards that applies across the country and a single primary regulator."[25] With federal preemption, FinTech firms would no longer need to rely on a bank-partnership model and would be free from what may be perceived as an onerous patchwork of regulations that vary state by state. In addition, FinTech firms have courted their own charter because they view the bank-partnership model as self-defeating, leaving them beholden to the banks and thus less able to innovate in the financial services arena.[26]

[22] See, e.g., *id.; Commonwealth of Pennsylvania v. Think Fin., Inc.*, No. 14-CV-7139, 2016 WL 183289 (E.D. Pa. Jan. 14, 2016); *CashCall, Inc. v. Comm'r of Fin. Regulation*, 139 A.3d 990 (Md. 2016); *CashCall, Inc. v. Morrisey*, No. 12-1274, 2014 WL 2404300 (W. Va. May 30, 2014), *cert. denied sub nom. CashCall, Inc. v. Morrissey*, 135 S. Ct. 2050, 191 L. Ed. 2d 956 (2015).

[23] Clozel, OCC Weighs New Charter for Fintech Firms, *supra* note 13.

[24] Rachel Witkowski & Telis Demos, *Fintech Startup Craves More Regulation*, WALL ST. J (June 9, 2016), www.wsj.com/articles/fintech-startup-craves-more-regulation-1465517775?mg=id-wsj (subscription required); *OCC: Fintech Firms Inquiring About National Bank Charters*, ABA BANKING JOURNAL (Mar. 11, 2016), bankingjournal.aba.com/2016/03/occ-fintech-firms-inquiring-about-national-bank-charters/ [perma.cc/XD7M-SSXP].

[25] Clozel, OCC Weighs New Charter for Fintech Firms, supra note 13.

[26] *Id.*

The OCC and Its Statutory Chartering Authority

The OCC's Chartering Authority

The National Currency Act of 1863 and the National Banking Act of 1864 ("NBA") created the OCC and granted it the statutory power to grant charters to national banks and serve as their primary regulator.[27] Created in the wake of the Civil War, national banks were designed to be federal entities that would help promote a uniform national currency.[28] This created a dual-banking system in the United States, with state-chartered banks regulated by a state banking regulator and national banks regulated by the OCC.[29] However, as federal instrumentalities, national banks chartered by the OCC enjoy broad federal preemption over state law.[30] Preemption of state regulatory authority and the competitive advantages that preemption might provide for national banks are at the heart of the current debate over FinTech charters.

The "Business of Banking"

Under the NBA, the OCC is charged with evaluating and approving applications for national bank charters and promulgating regulations to carry out these powers.[31] The OCC, however, may only grant charters for entities to engage in the "business of banking."[32] The business of banking is not, however, unambiguously defined in the NBA. Rather, the statute enumerates a list of five activities that are deemed "incidental powers" that are "necessary [for national banks] to carry on the business of banking."[33] This list of enumerated powers includes drafting and negotiating promissory notes and issuing other evidences of debt, taking deposits, buying and selling currency, making loans, and circulating currency.[34] In *Nations Bank of North Carolina, N.A. v. Variable Life Annuity Co* ("*VALIC*"), the Supreme Court expressly

[27] 12 U.S.C. § 1 *et seq*.
[28] www.occ.treas.gov/about/what-we-do/history/OCC%20history%20final.pdf [perma.cc/E39Y-4XG4].
[29] Barr, Jackson, Tahyar 38–39; www.fdic.gov/bank/analytical/banking/2006mar/article1/article1.pdf [perma.cc/S8EK-RVUM]. State-chartered banks are also regulated by the Federal Deposit Insurance Corporation (FDIC) and sometimes the Federal Reserve Board (FRB). www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_review/1990/pdf/er760601.pdf [perma.cc/GQ5T-E9XP].
[30] *See* Watters v. Wachovia.
[31] 12 U.S.C. §§ 21, 22, 26, 27, 93a.
[32] 12 U.S.C. §§ 26, 27.
[33] 12 U.S.C. § 24(seventh).
[34] *Id.*

held that the business of banking was not limited to this list of enumerated powers.[35] Rather, national banks have the authority to engage in a broad range of activities under the umbrella of the "business of banking."[36] This, according to the Supreme Court, vested the OCC with broad discretion to determine what constitutes the business of banking, as long as this determination is "reasonable."[37]

Special Purpose National Bank ("SPNB") Charters

Pursuant to its power to prescribe rules and regulations to carry out its statutory authority,[38] the OCC promulgated its SPNB chartering provisions in late 2003.[39] Under these provisions, the OCC determined that an entity would be eligible for a limited-purpose SPNB charter if it engaged in any one of three core banking activities: receiving deposits, paying checks, or lending money.[40] These three core banking activities were based on the NBA's statutory identification of activities that caused a facility to be considered a bank branch.[41] This list of three core banking activities was an attempt by the OCC to narrow the field of eligibility for SPNB charters.[42] The list was added by the OCC to the SPNB final rule after the notice and comment period because some commenters expressed concern that the eligibility for a SPNB charter was too broad and that it had the potential to preempt state oversight entities that were only tangentially engaged in the business of banking.[43]

The FinTech Charter

In December 2016, the OCC announced in a white paper that it was exploring SPNB charters for FinTech companies.[44] The December white paper announced that the OCC had the legal

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[35] See Nations Bank of North Carolina, N.A. v. Variable Life Annuity Co., 513 U.S. 251, 258 fn. 2 (1995) ("We expressly hold that the "business of banking" is not limited to the enumerated powers in § 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated.").

[36] *Id.*

[37] *Id.*

[38] 12 U.S.C. § 93A.

[39] Rules, Policies, and Procedures for Corporate Activities; Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 70122, 70126 (Dec. 17, 2003) (final rule). *See also* 12 CFR § 5.20.

[40] 12 CFR 5.20(e)(1)(i).

[41] 68 FR 70126 (citing 12 U.S.C. § 36).

[42] 68 FR 70126.

[43] *Id.*

[44] www.occ.treas.gov/topics/bank-operations/innovation/comments/special-purpose-national-bank-charters-for-fintech.pdf [perma.cc/2ZEN-DTBK].

authority to issue charters to FinTech companies—including FinTech firms that did not accept deposits—under the NBA and the SPNB provisions.[45]

In his comments at the Georgetown University Law Center, former Comptroller Thomas Curry added that the agency's decision was in the public interest because FinTech companies "hold great potential to expand financial inclusion, empower consumers, and help families and businesses take more control of their financial matters."[46] Comptroller Curry stressed that FinTech firms would have a choice in whether or not to seek a charter, and that the agency would closely scrutinize any charter application to ensure that the company protected consumers, had a solid structure, and would have a reasonable chance of success as a national bank.[47] The white paper reiterated that FinTech companies would "be held to the same high standards of safety and soundness, fair access, and fair treatment of customers that all federally chartered institutions must meet."[48] Finally, the white paper sought public comments as a means for feedback on its decision to consider applications for special purpose national bank charters for FinTech companies.[49]

In Defense of the OCC's Authority to Charter Non-depository FinTech Companies

In March 2017, the OCC released a draft supplement to the Comptroller's Licensing Manual which laid out how the OCC would evaluate application by FinTech companies for SPNB charters, indicating the agency's willingness to move forward with its proposal to issue charters to FinTech companies.[50] The OCC reiterated that it had the authority to issue such charters, including to FinTech companies that did not accept deposits.[51] According to the OCC, it has this authority because the OCC is vested with broad discretion to interpret the NBA's vague definition of the business of banking and nothing in the NBA explicitly requires that a bank receive deposits to be engaged in the business of banking.[52] Instead, the OCC's

[45] www.occ.treas.gov/topics/bank-operations/innovation/comments/special-purpose-national-bank-charters-for-fintech.pdf [perma.cc/2ZEN-DTBK]; 12 CFR 5.20(e)(1).
[46] https://www.occ.treas.gov/news-issuances/speeches/2016/pub-speech-2016-152.pdf [perma.cc/Q9SJ-FL8J].
[47] *Id.*
[48] www.occ.treas.gov/topics/bank-operations/innovation/comments/special-purpose-national-bank-charters-for-fintech.pdf [perma.cc/2ZEN-DTBK].
[49] *Id.*
[50] www.occ.gov/publications/publications-by-type/licensing-manuals/file-pub-lm-fintech-licensing-manual-supplement.pdf [perma.cc/F7E3-BFEV].
[51] www.occ.gov/topics/bank-operations/innovation/summary-explanatory-statement-fintech-charters.pdf [perma.cc/MX5N-CBM9].
[52] *Id.*

interpretation through its SPNB regulations is that the business of banking under the NBA is satisfied by engaging in any of the three core banking functions of receiving deposits, paying checks, or lending money.[53] Thus, according to the OCC, if any one of those three activities is being performed, a financial institution is engaging in the business of banking and therefore eligible for a national bank charter.[54]

In addition to the SPNB charter for FinTech companies, the OCC has also claimed the authority to charter other entities that do not take deposits through special purpose charters.[55] These entities include banker's banks and credit card banks.[56] The NBA—the OCC's organic statute—expressly grants the authority for the OCC to charter banker's banks (a financial institution owned by other depository institutions that performs limited services for banks and does not accept deposits from the public).[57] However, the NBA does not provide any express statutory grant of authority for the OCC to issue charters to credit card banks (banks that have a primary business of issuing credit cards and do not take deposits from the public).[58]

Instead, the statutory roots of credit card banks are traced back to the Bank Holding Company Act of 1956 ("BHCA").[59] As amended by the Competitive Equality Banking Act of 1987 ("CEBA"), credit card banks are considered a statutory exception to the definition of the term "bank" for purposes of the BHCA.[60] Typically, any company that owns a bank must become a bank holding company subject to regulation by the Federal Reserve Board of Governors. However, by excepting credit card banks from the definition of "bank," Congress has allowed companies to own credit card banks without becoming bank holding companies.[61] It is important to note, however, that this statutory exception to the definition of bank is, by its own terms, made applicable *only* to Chapter 17 of Title 12 of the U.S. Code

[53] *Id.*
[54] *Id.*
[55] www.occ.treas.gov/publications/publications-by-type/licensing-manuals/charters.pdf [perma.cc/Z5GV-D8RK] at 1.
[56] *Id.*
[57] 12 U.S.C. § 27(b)(1); *See* www.occ.treas.gov/publications/publications-by-type/licensing-manuals/charters.pdf [perma.cc/Z5GV-D8RK] at 108.
[58] *See* www.occ.treas.gov/publications/publications-by-type/licensing-manuals/charters.pdf [perma.cc/Z5GV-D8RK] at 51.
[59] 12 U.S.C. § 1841 et seq.
[60] 12 U.S.C. § 1841(c)(2)(F); *See* www.occ.treas.gov/publications/publications-by-type/licensing-manuals/charters.pdf [perma.cc/Z5GV-D8RK] . Competitive Equality in Banking Act of 1987 (CEBA), Pub. L. No. 100-86, § 101, 101 Stat. 552, 554 (1987), codified at 12 U.S.C. § 1841(c) (credit card banks).
[61] www.occ.treas.gov/publications/publications-by-type/licensing-manuals/charters.pdf [perma.cc/Z5GV-D8RK]

(the BHCA)—which deals only with bank holding companies regulated by the Federal Reserve Board of Governors.[62] By contrast, the OCC's national bank chartering authority stems from the NBA—Chapter 2 of Title 12 of the U.S. Code—an entirely separate statutory scheme from the BHCA with a different statutory purpose. Thus, while the BHCA exempts companies that own credit card banks from becoming bank holding companies, it is not a statutory grant of authority for the OCC to charter credit card banks. Rather, the OCC charters these credit card banks as SPNBs under the same SPNB regulation—12 CFR § 5.20(1)—that it intends to use for FinTech companies. Under this SPNB regulation, credit card banks, like many FinTech companies, are eligible for the SPNB charter because they engage in one of the "core" enumerated banking activities—extending loans—even though they do not take deposits.[63]

Critical Responses to the White Paper

Lawsuit and Commenters Argue That the OCC Lacks the Statutory Authority to Charter Non-Depository Institutions

In response to the OCC's invitation for comments on its proposal to extend national bank charters to FinTech companies, a number of entities questioned the OCC's legal authority to extend such charters to non-deposit taking entities without an express grant of authority from Congress.[64] The leading commenter questioning the OCC's legal authority was the Conference of State Bank Supervisors ("CSBS"), which eventually filed suit against the agency in April 2017.[65] CSBS members stand to lose a measure of regulatory control if the OCC decides to charter entities, as state banking supervisors are currently the primary regulator of FinTech companies, and a federal charter would essentially preempt their supervisory authority over these companies. However, CSBS was not alone in questioning the OCC's legal authority. The National Consumer Law Center ("NCLC"),[66] the Center for

[62] *See* 12 U.S.C. § 1841(c) ("*For purposes of this chapter*. . .[t]he term "bank" does not include . . ." credit card banks) (emphasis added).

[63] www.occ.gov/static/interpretations-and-precedents/oct05/crad126.pdf [perma.cc/3S96-NN5M] (outlining the OCC's conditional approval of a charter under 12 CFR § 5.20 for Department Stores National Bank, a credit card bank that does not accept deposits).

[64] See, e.g., www.occ.treas.gov/topics/responsible-innovation/comments/comment-csbs-comment-letter-special-purpose-national-bank-charters-fintech.pdf [perma.cc/ZV8J-KGE9].

[65] www.occ.treas.gov/topics/responsible-innovation/comments/comment-csbs-comment-letter-special-purpose-national-bank-charters-fintech.pdf [perma.cc/ZV8J-KGE9]; CSBS Complaint.

[66] www.occ.treas.gov/topics/responsible-innovation/comments/comment-nclc-et-al.pdf [perma.cc/3XVU-4KJK].

Responsible Lending ("CRL"),[67] the Independent Community Bankers Association ("ICBA"),[68] the New York Attorney General,[69] and the Illinois Department of Financial and Professional Regulation[70] have each questioned the OCC's legal authority to grant charters to non-deposit taking institutions. These groups also expressed concerns beyond questioning the OCC's legal authority—including consumer protection concerns[71] and fears over increased competition for community banks.[72] Additionally, two Senators from the Senate Banking Committee expressed their concern that "[b]ecause many of these [FinTech] firms evidently do not intend to accept deposits, it is far from clear whether the OCC has authority to grant national bank charters to them."[73]

CSBS argues that the OCC is limited to chartering either (1) entities engaged in the business of banking, which must include the acceptance of deposits; or (2) entities that are not engaged in the business of banking, but only pursuant to an explicit grant of authorization from Congress.[74] The foundation of this argument first rests on the premise that the business of banking *necessarily* includes taking deposits.[75] Second, any federally-chartered entity that does not accept deposits is not engaged in the business of banking, but was eligible for its charter because the OCC could trace that chartering authority back to some grant of statutory authority from Congress.[76] Hence, the OCC can issue charters to non-depository banker's banks and credit card banks only because of the limited exceptions made by Congress to the business of banking requirement.[77] Thus, CSBS argues, the OCC may not

[67] www.occ.treas.gov/topics/responsible-innovation/comments/comment-crl.pdf [perma.cc/EC45-VWL6].
[68] www.occ.treas.gov/topics/responsible-innovation/comments/comment-independent-community-bankers.pdf [perma.cc/DN5X-EBSZ].
[69] www.occ.treas.gov/topics/responsible-innovation/comments/comment-ny-atty-general.pdf [perma.cc/67XX-F7AK].
[70] www.occ.treas.gov/topics/responsible-innovation/comments/comment-idfpr.pdf [perma.cc/7S37-HFAW].
[71] www.occ.treas.gov/topics/responsible-innovation/comments/comment-nclc-et-al.pdf [perma.cc/3XVU-4KJK] at 13.
[72] www.occ.treas.gov/topics/responsible-innovation/comments/comment-independent-community-bankers.pdf [perma.cc/DN5X-EBSZ] at 5.
[73] http://www.banking.senate.gov/public/index.cfm/democratic-press-releases?ID=F70DB4BF-5E75-4ED7-B54B-1DE3C844E55F
[74] www.occ.treas.gov/topics/responsible-innovation/comments/comment-csbs-comment-letter-special-purpose-national-bank-charters-fintech.pdf [perma.cc/ZV8J-KGE9]; CSBS Complaint.
[75] www.occ.treas.gov/topics/responsible-innovation/comments/comment-csbs-comment-letter-special-purpose-national-bank-charters-fintech.pdf [perma.cc/ZV8J-KGE9].
[76] *Id.*
[77] *Id.*

grant charters to FinTech companies that do not accept deposits unless Congress weighs in and give the agency the power to do so.[78]

The Case Law Supporting the CSBS Position: IBAA v. Conover

The rationale behind the CSBS argument stems primarily from the 1985 *Conover* decision announced in the District Court for the Middle District of Florida.[79] In *Conover*, the Independent Bankers Association of America ("IBAA") challenged the OCC's legal authority under the NBA to grant a charter to an entity that did not accept deposits, claiming economic injury from the competitive advantages that these entities might have over IBAA members.[80] The court recognized that under the NBA, the OCC could only grant charters to institutions engaged in the business of banking.[81] Without engaging in the administrative deference analysis announced by the Supreme Court a year earlier in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*,[82] the *Conover* Court announced that it would glean the definition of the business of banking by looking to "historical understanding in law and custom."[83]

Under the historical understanding inquiry, the court determined that deposit taking and lending money are at the core of banking and that a financial institution that is legally unable to engage in both activities cannot be engaged in the business of banking under the NBA.[84] The court found support for this proposition from a number of sources. First, the court opined that, traditionally, all banks were considered commercial banks and, from a historical perspective, virtually all national banks had been commercial banks that accepted deposits.[85] The court proceeded to cite a textbook that stated the uniqueness of commercial banks stemmed from the nature of their liabilities — demand deposits.[86] The court then quoted from the Supreme Court's *Mercantile National Bank v. Mayor*[87] decision, which noted that "the business of banking, as defined by law and custom, consists in . . . receiving deposits

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[78] *Id.*
[79] Independent Bankers Ass'n of America v. Conover, 1985 U.S. Dist. LEXIS 22529 (M.D. Fla. Feb. 15, 1985).
[80] *See id.* at *8–*9.
[81] *See id.* at *22–*23.
[82] 467 U.S. 837 (1984)
[83] 1985 U.S. Dist. LEXIS 22529 at *23.
[84] *Id.* at *22–*23; *30–*38.
[85] IBAA v. Conover, at *24-*25, *28.
[86] IBAA v. Conover, at *24-*25 (citing S.M. Goldfeld & L.V. Chandler, The Economics of Money and Banking 87-88 (8th Ed. 1981)).
[87] 121 U.S. 139 (1887).

payable on demand . . . ."[88] Finally, the *Conover* Court cited the Supreme Court's *United States v. Philadelphia National Bank*[89] case, which explained that banks have traditionally relied on demand deposits as a very large part of their working capital.[90] The court surmised that traditional and historical understandings of banks led to the conclusion that the business of banking necessarily included taking deposits, and the OCC had presented no evidence to the contrary.[91]

The court went on to note that the few historical instances where the OCC has chartered non-deposit-taking banks, such as banker's banks and national trust associations, Congress had expressly granted the OCC permission to charter such entities.[92] When the OCC tried to grant charters to these types of entities before Congress had given the agency the power to do so, courts had enjoined the OCC from granting such charters.[93] The *Conover* Court noted that in response to prior judicial injunctions, the OCC requested express approval to charter these entities from Congress, and Congress responded by granting the OCC authority to charter banker's banks and national trust associations that do not accept deposits.[94] The court interpreted that the Congressional actions in these instances were carefully limited additions to the OCC's authority through specific amendments and not a fundamental change in the definition of the business of banking.[95] Hence, the *Conover* Court concluded that receiving deposits was an essential element of the business of banking and a necessary precondition of eligibility for a national bank charter, unless Congress expressly provided otherwise.[96] The *Conover* Court ultimately granted a preliminary injunction against the OCC based on its conclusion that IBAA would likely win on the merits because the OCC was

[88] IBAA v. Conover, at *25-*26 (citing *Mercantile National Bank v. Mayor*, 121 U.S. 139, 156 (1887).
[89] 374 U.S. 321 (1963)
[90] IBAA v. Conover, at *26-*27 (citing *United States v. Philadelphia National Bank* 374 U.S. 321, 326–27 (1963)).
[91] IBAA v. Conover, at *30–*33.
[92] *See id.* at *34–*36.
[93] *Id.* (citing *National State Bank of Elizabeth v. Smith,* No. 76-1479 (D.N.J. September 16, 1977), *rev'd on other grounds,* 591 F.2d 223 (3d in 1979) (holding that the OCC lacked the authority to grant charters to trust companies that did not accept deposits)).
[94] *Id.* (citing 12 U.S.C. §§ 27(a), (b)(1)). *See* Financial Institutions Regulatory and Interest Rate Control Act of 1978 (FIRIRCA), Pub. L. No. 95-630, § 1504, 92 Stat. 3641 (1978) (codified at 12 U.S.C. § 27(a) (national trust banks); Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 404, 96 Stat. 1511 (1982) (codified at 12 U.S.C. § 27(b)(1)) (bankers' banks).
[95] *Id.*
[96] *See id.* at *33–*38.

attempting to issue a charter to a non-deposit-taking entity not subject to any specific statutory exception.[97]

The Aftermath of Conover

The Comptroller sought to lift the injunction from *Conover* in 1987, but the motion was ultimately denied.[98] Further litigation was dropped when CEBA was passed in 1987, which amended the BHCA to allow companies to own non-deposit-taking entities like credit card banks and national trust companies without becoming a bank holding company. This exception was set forth in the definition of the term "bank" for purposes of the BHCA.[99] According to CSBS's interpretation, the passage of CEBA reflected Congress's effective ratification of the *Conover* decision, because it made clear that financial institutions that do not accept deposits are not "banks."[100]

Based on the *Conover* decision and CEBA's amendment to the BHCA, the CSBS lawsuit as well as the critical commenters argue that, as a matter of law, the OCC cannot grant charters to non-deposit-taking FinTech companies and attempts to do otherwise would be unlawful and invalid.[101] According to CSBS, not only had Congress not authorized the OCC to charter non-deposit-taking FinTech companies, but also it intended to prohibit the chartering of any non-depository institutions as banks without express authorization.[102] CSBS finds support for this proposition comes from the BHCA, which states that the term "bank" means either a bank insured by the FDIC[103] or an institution that "accepts deposits" and "makes commercial loans."[104] Thus, CSBS argues that "[t]he term 'bank,' as so defined, does not include a special purpose institution that makes loans but does not accept deposits."[105]

Finally, CSBS argues that the OCC's 2003 SPNB regulation was an invalid exercise of agency authority after the *Conover* case.[106] Because the OCC's regulations allowed the agency to

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[97] *See id.* at *38.
[98] Independent Bankers Ass'n v. Conover, (April 4, 1987), discussed in 55 U.S.L.W. 2550.
[99] www.occ.treas.gov/topics/responsible-innovation/comments/comment-csbs-comment-letter-special-purpose-national-bank-charters-fintech.pdf [perma.cc/ZV8J-KGE9].
[100] *Id.*
[101] *Id.*
[102] *Id.*
[103] 12 U.S.C. § 1841(c)(1)(A)
[104] *Id.*
[105] www.occ.treas.gov/topics/responsible-innovation/comments/comment-csbs-comment-letter-special-purpose-national-bank-charters-fintech.pdf [perma.cc/ZV8J-KGE9].
[106] *Id.*

charter financial institutions that did not necessarily accept deposits, CSBS characterized this as an "unprecedented and unauthorized regulatory expansion" beyond the OCC's statutory authority. However, for 14 years, the OCC did not use this authority to charter a non-depository SPNB beyond the entities recognized by statute. The December 2016 white paper was the first time that the OCC announced that it intended to use the SPNB regulation for this purpose.[107]

Conclusion

After reading these comments, the Comptroller approached the OCC Office of General Counsel and has asked for your legal advice on the OCC's authority to offer SPNB charters to FinTech companies that do not take deposits. In your response, the Comptroller has asked you to address the following questions:

- Does the NBA grant the OCC the authority to issue national bank charters to entities that do not accept deposits?
- What is the best legal argument that can be asserted in response to the CSBS suit?
- If you believe the NBA does grant the OCC the authority to charter non-depository FinTech companies, what is your confidence that the OCC will win the suit against CSBS? (In responding to this question, please do not concern yourself with issues of standing or applicable statutes of limitations)
- Even if the OCC has the legal authority to grant such charters, what is your policy recommendation regarding whether the agency should move forward and issue SPNB charters to FinTech companies? Is it worth the potential political and interest-group blowback, or would it be best to leave it to Congress to decide whether such charters should be made available to FinTech companies?

[107] *Id.*

Appendix List

Item 1: 12 U.S.C. §§ 21, 22, 24(seventh), 26, 27, 93a (2012).

Item 2: 12 C.F.R. § 5.20(e)(1) (2017).

Item 3: Rules, Policies, and Procedures for Corporate Activities; Bank Activities and Operations; Real Estate Lending and Appraisals, 68 Fed. Reg. 70122, 70126 (Dec. 17, 2003) (final rule).

Item 4: Complaint, *Conference of State Bank Supervisors v. Office of the Comptroller of the Currency*, No. 1:17-cv-00763, 2017 WL 1488257 (D.D.C. Apr. 26, 2017).

Item 5: *Independent Bankers Ass'n of America v. Conover*, 1985 U.S. Dist. LEXIS 22529 (M.D. Fla. Feb. 15, 1985). Note: This version of the case cannot be publicly reprinted. Access this case using the above citation or in Lexis.

Item 6: Excerpt from Draft OCC Brief