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SPECIAL BULLETIN

Feds Boost Innovation and Begin Occupying the Field: Treasury Department Report & OCC FinTech Charter

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On July 31, 2018, the Treasury Department released its report on regulatory reform for nonbank financial institutions, financial technology and financial innovation (Treasury Report). Among other issues, it recommended the issuance of FinTech national bank charters, the repeal of the Consumer Financial Protection Bureau's (CFPB) payday rule, and the "updating" or adoption of Federal guidelines on a range of activities from nonbank lending to data breach notification. Within hours, the Office of the Comptroller of the Currency (OCC) announced that it will begin accepting applications for FinTech special purpose national bank charters. Significant time will pass before other reforms recommended by the Treasury are adopted or any FinTech company begins to operate under a national bank charter. Yet these moves by the OCC and Treasury are crucial to lay the groundwork for a Federal regulatory framework that is not only more hospitable to industry, but also potentially immediately useful in forestalling stringent and fragmented State regulation.

Treasury Reform Recommendations

The 222-page Treasury Report, titled *A Financial System That Creates Economic Opportunities - Nonbank Financials, Fintech, and Innovation*, is the fourth and final report in a series of evaluations of the financial regulatory framework mandated by Executive Order from President Trump.

Directed primarily at financial innovation, the Treasury Report encouraged the OCC's FinTech national bank charter initiative and recommended that Federal and State regulators establish a unified "regulatory sandbox" for FinTech entities to innovate without fear while abiding by certain guidelines and oversight. The Report applauded Vision 2020, a multi-State coordination effort by the Conference of State Bank Supervisors (CSBS) that includes establishment of a Fintech Industry Advisory Panel to advance and harmonize State FinTech regulation. The Report supported unified State licensing and supervisory regimes, including a State license passporting regime. If financial regulators are unable to achieve timely, meaningful harmonization, however, the Report recommended that Congress enact legislation to establish uniform processes and preempt State laws if necessary. Overall, while encouraging regulatory harmonization, many of the Federal guidelines recommended by the Report ultimately pave the way for Federal preemption.

The Report nevertheless credited the role of State regulation in other areas to support Federal deregulation. For instance, in advocating repeal of the CFPB payday rule, the Report noted that the States already have broad authority in this area, making Federal regulation unnecessary. The Report further recommended that both Federal and State banking regulators take steps to encourage short-term lending by banks. It commended the OCC's May 2018 bulletin encouraging installment loans and recommended that the Federal Deposit Insurance Corporation (FDIC) follow the OCC's lead in rescinding the 2013 supervisory guidance which severely limits banks' offering of deposit advance products.

The Report was not shy to recommend Federal preemption where needed. For instance, while recognizing existing data security requirements, it emphasized the need for additional Federal action to address how financial data is used, aggregated and secured. The Report included a series of recommendations for Congress to enact legislation that would include national standards for data security and breach notification, explicitly preempting State data breach laws. (Congressional efforts have stalled due to disagreement over who should bear liability in the event of a breach.)

Likewise, the Report recommended that Congress codify the "valid when made" doctrine and the role of the bank as the "true lender" of loans it makes – to counter the Second Circuit's 2015 *Madden v. Midland Funding* ruling that cast doubt on the well-established precedent that loans sold by banks to third parties, such as FinTech entities and debt collectors, are not subject to the usury caps of the States where the loan purchaser is located.

The Report also included recommendations in a variety of other areas, including for example:

- Harmonizing guidance on bank/non-bank partnerships;
- Accommodating the use of alternative data to expand access to credit;
- Continuing the Federal Reserve's work to facilitate a faster retail payments system;
- Updating regulations to accommodate digital communications under the Telephone Consumer Protection Act and Fair Debt Collection Practices Act; and
- Updating regulations to accommodate end-to-end digital mortgage (*e.g.*, acceptance of digital promissory notes, digital notary standards, automated appraisals).

Regulators could effectuate approximately two-thirds of the Treasury Report's recommendations without action from Congress, where political gridlock is likely to meet any reform effort.

OCC FinTech National Bank Charter

A FinTech national bank charter initiative has been on the OCC's agenda since December 2016, long before the Treasury Report's recommendation, but changes in administration and leadership have delayed implementation. Comptroller Otting's announcement that the OCC will accept applications for FinTech special purpose national bank charters provided welcome relief for the sector. Many FinTech entities will forego applying for a charter, given requirements to abide by the demanding traditional federal banking regulatory framework. The OCC's announcement nevertheless benefits the entire sector, by providing incentives for the States to harmonize their regulations and provide greater accommodations for FinTech entities.

The OCC has published a policy statement and supplement to the *Comptroller's Licensing Manual* to begin accepting applications for special national bank charters from non-depository FinTech companies. (Consistent with the Treasury Report's recommendation, this special bank charter would be limited to entities that do not accept insured deposits.) Chartered FinTech companies would be subject to the same Federal regulatory framework as traditional banks, including capital, liquidity and financial inclusion commitments. They would have to submit a contingency plan to address financial stress that could threaten the viability of the bank, including strategies for recovery and options for selling, merging or liquidating the institution if recovery strategies prove ineffective. Moreover, like other de novo banks, they would be subject to heightened supervision initially.

The OCC relies on its statutory authority over companies that engage in *one* of the core banking functions (paying checks, lending money or taking deposits). The New York State Department of Financial Services (DFS) and CSBS filed suits in 2017 to challenge the OCC's authority under the National Bank Act to issue national bank charters to firms that do not accept deposits. Those suits were dismissed as premature as the OCC had not yet finalized its FinTech bank charter process nor issued any such charter. The States are likely to renew their opposition, promising litigation for years to come.

Many FinTech entities may forego applying for an OCC national bank charter. Some may hope to obtain an industrial loan company (ILC) charter from the FDIC. Newly installed Chairman McWilliams has directed staff to expedite the FDIC application process and may view ILC applications with a more favorable eye. Moreover, among other indicators, the Treasury Report recommendations to smooth the path for bank/non-bank partnerships may encourage FinTech entities to continue along that more familiar path to avoid the complexities of a patchwork of demanding state regulation. At a minimum, these options for FinTech companies to avoid piecemeal State regulation provide strong incentives for the States to harmonize their activities and provide greater accommodations, including in the manners recommended by the Treasury Report – spelling good news for the entire FinTech sector.

Likewise, the increased potential for Federal preemption based on the actions recommended under the Treasury Report is good news for the financial industry as a whole.

The attorneys of Stroock's Financial Services Litigation, Regulation & Enforcement Group are well positioned to answer any questions you may have about financial regulatory reform, compliance, investigation, litigation and related issues.

For More Information

Quyen T. Truong
202.739.2888
qtruong@stroock.com

New York
180 Maiden Lane
New York, NY 10038-4982
Tel: 212.806.5400
Fax: 212.806.6006

Los Angeles
2029 Century Park East
Los Angeles, CA 90067-3086
Tel: 310.556.5800
Fax: 310.556.5959

Miami
Southeast Financial Center
200 South Biscayne Boulevard, Suite 3100
Miami, FL 33131-5323
Tel: 305.358.9900
Fax: 305.789.9302

Washington, DC
1875 K Street NW, Suite 800
Washington, DC 20006-1253
Tel: 202.739.2800
Fax: 202.739.2895

www.stroock.com