Clients&FriendsMemo

Marketplace Lending Update #6: Is the Fintech Charter the Solution? Don't Bank on It

May 9, 2019

Many have believed that the national bank "fintech charter" is an ideal solution to providing marketplace consumer loans on a 50-state basis. A recent ruling from the Southern District of New York casts significant doubt on the viability of obtaining such a charter, at least in the near term.

In December 2016, the Office of the Comptroller of the Currency ("OCC") announced its intention to consider the chartering of special purpose national banks to financial technology companies that provide banking products and services. Under the proposal, such "fintech charter" banks would not be required to operate as full service national banks and, importantly, would not be required to accept deposits, as long as they engage in activities considered by the OCC to be core activities within the "business of banking," such as lending and payment processing.

The OCC's proposal resonated with the marketplace lending industry because national banks are not subject to certain state lending laws. In particular, national banks are exempt from state licensing and examination requirements.[1] National banks may "export" interest rates – as well as other lending features deemed "material to the determination of the interest rate" (such as balance-calculation methodology and certain fees, such as late fees) from the national bank's home state,[2] all without regard to licensing, usury or other restrictions imposed by the law of any other state.

These two powers – the immunity from state licensing and examination requirements and the ability to export interest rates – permit a national bank to lend to consumers seamlessly across all 50 states, without regard to the patchwork of state consumer-loan laws. These two powers are particularly attractive to marketplace lenders because the higher rates charged by lenders can be problematic in a number of states unless a state license is obtained. For those lenders, state licensing is no panacea: obtaining such licenses can be a years-long process, and maintaining licenses in good standing across all 50 states can be costly and burdensome. The national bank fintech charter also would serve as an alternative to the "bank-origination model" used by some

1 *See* 12 U.S.C. § 484 (referring to the statutory preemption of state "visitorial powers").

2 *See* 12 U.S.C. § 85.

marketplace lenders. That term refers to the practice used by some marketplace lenders to partner with FDIC-insured state-chartered banks to originate loans on the marketplace lender's behalf,[3] enabling the marketplace lender to obtain consumer loans without having to partner with – and share revenue with – a third-party bank.

When the OCC announced the proposed fintech charter concept in December 2016, the OCC stated that such a national bank would be subject to many requirements applicable to national banks today, *but would not be required to accept deposits at all*. While such a nondepository fintech bank would be a national bank under the National Bank Act (and thus could claim immunity from state regulation and export interest rates), the nondepository fintech bank would *not* be a "bank" under the Bank Holding Company Act (the "BHC Act"). Under the BHC Act, a "bank" is defined as including either an (i) "insured bank" as defined in the Federal Deposit Insurance Act (*i.e.*, a banking institution the deposits of which are FDIC-insured) or (ii) an institution that both accepts demand deposits and makes commercial loans. A nondepository fintech national bank would arguably be neither and thus would not be a "bank" under the BHC Act.

This was a critical factor for the marketplace lending industry. The BHC Act requires a company that acquires control of a "bank" to register as a bank holding company and become subject to Federal Reserve supervision. The BHC Act also imposes significant restrictions on bank holding companies and affiliates of banks, including restrictions on the activities in which they may engage, companies they may acquire, capital and liquidity requirements, anti-money laundering procedures, and the like. As a result of the OCC's conclusion that a fintech charter national bank would not have to accept deposits, these requirements of the BHC Act would not apply to a fintech national bank and its parents and affiliates. This would allow, for example, a fintech national bank to be controlled by a fund or by a company engaged in commercial activities.

The OCC invited comments on the proposed fintech charter concept from December 2016 through January 2017. Over one hundred comment letters were received. Many commenters applauded the proposal, agreeing with the OCC that permitting a fintech national bank facilitated innovative lending on a responsible basis and was necessary to keep pace with technological developments. Others criticized the OCC's proposal, arguing that it would permit marketplace lenders to circumvent state laws designed to protect consumers from high rate loans and questionable lending practices.

In the spring of 2017, the OCC's proposal was challenged in two lawsuits – one brought by the Conference of State Bank Supervisors (the "CSBS"), and the other brought by the Superintendent of the New York Department of Financial Services (the "DFS"). Both lawsuits were dismissed over

[3] For a discussion of the bank origination model, see our Clients & Friends Memo, *Marketplace Lending Update: Who's My Lender?* (Mar. 14, 2018).

standing and ripeness concerns.[4] Those dismissals, however, were based in part on the fact that the OCC had not yet decided whether to proceed with the fintech charter concept.

On July 31, 2018, the OCC formally announced that it would begin accepting fintech charter applications.[5] The CSBS and the DFS promptly refiled their lawsuits.[6] Both lawsuits sought to enjoin the OCC from proceeding with its proposal, arguing that the OCC's policy statement on fintech charters exceeded the OCC's authority under the National Bank Act because the Act does not permit the chartering of nondepository national banks. The CSBS and the DFS also argued that Section 5.20(e)(1) of the OCC's regulations – which empowered the OCC to issue special purpose charters to any entity that engages in at least one of the "core activities" of either receiving deposits, paying checks, or lending money[7] – exceeded the OCC's authority under the National Bank Act.[8]

The OCC moved to dismiss both cases, arguing that the OCC's authority to permit fintech charter national banks was a reasonable interpretation of the National Bank Act by the OCC and was thus entitled to deference under *Chevron U.S.A., Inc. v. National Resources Defense Council, Inc.*[9] ("*Chevron*").[10] In *Chevron*, the Supreme Court set forth its now famous standard for judicial review of a federal agency's interpretation of the statute that it administers – one that defers to agencies' interpretations absent direct guidance from Congress:

> When a court reviews an agency's construction of the statute which it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly

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4 *See Conference of State Bank Supervisors v. Office of Comptroller of Currency*, 313 F. Supp. 3d 285 (D.D.C. 2018); *Vullo v. Office of Comptroller of Currency*, No. 17 CIV. 3574 (NRB), 2017 WL 6512245 (S.D.N.Y. Dec. 12, 2017).

5 *See* Office of the Comptroller of the Currency, *Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters* (July 31, 2018).

6 *See* Complaint for Declaratory and Injunctive Relief, *Vullo v. Office of Comptroller of Currency et al.*, No. 1:18-cv-8377 (S.D.N.Y. Sept. 14, 2018), ECF No. 1; Complaint for Declaratory and Injunctive Relief, *Conference of State Bank Supervisors v. Office of Comptroller of Currency et al.*, No. 1:18-cv-02449 (D.D.C. Oct. 25, 2018), ECF No. 1.

7 *See* 12 C.F.R. § 5.20(e)(1).

8 In both cases, the plaintiffs also argued that the OCC's policy statement violated the Tenth Amendment to the U.S. Constitution. In its litigation, CSBS also asserted that the OCC's policy statement violated the Administrative Procedures Act's procedural requirements and was arbitrary and capricious.

9 467 U.S. 837 (1984).

10 The OCC also argued that the DFS lacked standing to litigate, that the dispute was unripe because the OCC had not yet issued such a charter, and that the challenge to Section 5.20(e) was time-barred given that the language in question had been promulgated in 2003.

> addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.[11]

On May 2, 2019, the Southern District denied the OCC's motion to dismiss in the DFS lawsuit.[12] With respect to the OCC's *Chevron* argument, the court ruled that the National Bank Act was not ambiguous, and thus the OCC's interpretation of the Act warranted no judicial deference. The Court concluded that:

> the [National Bank Act's] "business of banking" clause, read in the light of its plain language, history, and legislative context, unambiguously requires that, absent a statutory provision to the contrary, only depository institutions are eligible to receive national bank charters from OCC.[13]

The Court's order refusing to grant the motion to dismiss is seemingly fatal to the OCC's fintech charter proposal, at least insofar as the Southern District of New York is concerned. By concluding that the National Bank Act unambiguously requires that only deposit-taking institutions may receive national bank charters, the Court's ruling goes to the very heart of the OCC's position – that is, that national bank fintech charters should also be available to entities engaged solely in nondepository activities, such as lending or payment processing.

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[11] 467 U.S. 837 at 842-43 (footnotes omitted).

[12] The Court rejected the OCC's arguments concerning ripeness and standing, although it agreed with the OCC that the DFS's count based on the Tenth Amendment failed to state a claim and thus dismissed that count of the DFS complaint.

[13] *See* Decision and Order, *Vullo v. Office of the Comptroller of the Currency et al.*, No. 1:18-cv-8377 (S.D.N.Y. May 2, 2019), ECF No. 28. The court noted in particular that the term "business of banking" is commonly understood to entail the taking of deposits, and that only two forms of nondepository national banks had been previously chartered by the OCC – trust banks and bankers banks – but that these two forms of nondepository banks had been specifically authorized by Congress pursuant to statute. Furthermore, the Court expressed skepticism that Congress would have intended the OCC to grant fintech charters absent statutory approval, noting that the fintech proposal:

> would entail federal preemption of the state banking regulatory scheme nationwide as it relates to such fintech entities. Such dramatic disruption of federal-state relationships in the banking industry occasioned by a federal regulatory agency lends weight to the argument that it represents exercise of authority that exceeds what Congress may have contemplated in passing the NBA. . . .
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> Indeed, if DFS's characterization of the impact is accurate – which the Court assumes, given the posture of this Order, the OCC's reading is not so much an "interpretation" as "a fundamental revision" of the NBA – essentially exercise of a legislative function by administrative agency fiat. . . . Whether depository institutions can qualify as national banks appears to be "a question of deep 'economic and political significance' that is central to this statutory scheme," such that the Court infers that, because of its fundamental regulatory, legislative, and constitutional implications, "had Congress wished to assign that question to an agency, it surely would have done so expressly."

Id. at 46-47 (citations omitted).

At this point, it is unclear what the OCC's next steps will be. The District Court for the District of Columbia has yet to rule on the OCC's motion to dismiss in the CSBS litigation, and that court may reach a different conclusion.

For the time being, therefore, it seems unlikely that the OCC will proceed with the processing of fintech charter applications for nondepository banks. And even if the OCC does continue processing, applicants should be wary that any national bank charter received is of dubious legality unless and until the Second Circuit or Supreme Court sides with the OCC. Thus, marketplace lenders have two avenues available to them: assume the burden of state-by-state licensing, or rely on the "bank origination model" to originate receivables but with risk in some states – such as in Colorado – that the state may attempt to challenge the viability of that model.[14]

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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[14] For a discussion of Colorado's challenge to the bank origination model, see our prior Clients & Friends memo, *Marketplace Lending Update #5: The Very Long Arm of Colorado Law* (Apr. 24, 2019).