January 15, 2017

Mr. Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
Washington, DC
specialpurposecharter@occ.treas.gov

Re: Exploring Special Purpose National Bank Charters for Fintech Companies

Dear Mr. Curry:

Americans for Financial Reform (AFR) appreciates the opportunity to comment on the Office of the Comptroller of the Currency's (OCC) Exploring Special Purpose National Bank Charters for Fintech Companies (White Paper).[1] AFR is a coalition of over 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[2]

Issuing Nondepository Charters Would Undermine State Customer Protections

We along with more than 250 organizations separately submitted a letter urging the OCC to refrain from issuing charters to nondepository fintech lenders because doing so would enable the chartered entities to avoid state interest rate caps and other state consumer protection laws, as well as state oversight, thereby putting consumers and small businesses at risk. AFR also agrees with the comments of the National Consumer Law Center, Center for Responsible Lending, and Main Street Alliance, which describe these problems in greater detail.

The OCC Does Not Have Authority To Charter Nondepository Lenders

Nondepository lenders are not "[a]ssociations for carrying on the business of banking"[3] within the meaning of the National Bank Act (NBA). "The case law takes for granted that the core of the business of banking as defined by law and custom is accepting demand deposits ***and*** making

[1] Office of the Comptroller of the Currency, Exploring Special Purpose National Bank Charters for Fintech Companies (2016), https://www.occ.treas.gov/topics/bank-operations/innovation/special-purpose-national-bank-charters-for-fintech.pdf ("White Paper").

[2] A list of AFR member organizations is available at http://ourfinancialsecurity.org/about/our-coalition/

[3] 12 U.S.C. § 21 (2014).

commercial loans."[4] There is simply no reason to believe that the Civil War-era Congress authorized the OCC to charter – as banks – institutions that do not take deposits.

The history of the OCC's previous attempt to charter nondepository institutions is illustrative of this principal. When the OCC attempted to charter a nondepository trust bank, a federal court enjoined the action as exceeding the Comptroller's authority.[5] In response, Congress specifically granted the OCC authority to charter nondepository trust banks.[6] Only then could the OCC charter nondepository trusts as national banks.[7]

The cases cited by the White Paper are not persuasive.[8] Both cases the White Paper cites hold that banks may provide financial services beyond deposit taking, traditional lending, and other powers specifically enumerated by 12 U.S.C. § 24 (Seventh), because they are "incidental powers as shall be necessary to carry on the business of banking."[9] Neither case, however, addresses the question at issue here: whether an institution that does not take deposits is an "association[] for . . . the business of banking" absent a specific statute deeming it to be one.

The depository-nondepository distinction is consequential. Congress has repeatedly granted banking agencies additional authorities necessary to regulate modern depository institutions, while not enacting any analogous legislation that would encompass nondepository institutions. The OCC's charter of a nondepository entity would thereby thwart the policy objectives of numerous foundational banking statutes, and undermine the OCC's authority -- as well as the authority of other agencies -- to regulate the banking industry.

- **Chartering nondepositories would undermine the federal policy against mixing commerce and banking.** Under the Bank Holding Company Act (BHCA), the Federal Reserve Board of Governors has the authority to regulate most companies that own banks

[4] *Indep. Bankers Ass'n of Am. v. Conover,* No. 84-1403-CIV-J-12, Fed. Banking L. Rep. (CCH) ¶ 86,178, 1985 U.S. Dist. LEXIS 22529 (M.D. Fla. Feb. 15, 1985) (emphasis added).

[5] *See Nat'l State Bank of Elizabeth, NJ v. Smith*, No. 76-1479 (D.N.J. Sept. 16, 1977), *rev'd as superseded by statute* 591 F.2d 223 (3d Cir. 1979).

[6] *See* Pub. L. No. 95-630 § 1504 (1978) (codified at 12 U.S.C. § 27(a) (2014)).

[7] It is noteworthy that the trust powers granted to a federally-chartered entity must abide by the limitations of state law (contrary to the claimed powers of a nondepository lender to preempt state usury caps). *See* 12 U.S.C. § 92a; *St. Louis County Nat'l Bank v. Mercantile Trust Co. Nat'l Ass'n*, 548 F.2d 716 (8th Cir. 1976).

[8] White Paper at 4 n.7.

[9] *Nationsbank of North Carolina, N.A. v. Variable Annuity Life Ins. Co.,* 513 U.S. 251, 256 (1995) (holding § 24 (Seventh) permits a bank to sell annuities); *M&M Leasing Corp. v. Seattle First Nat'l Bank*, 563 F.2d 1377 (9th Cir. 1977) (holding § 24 (Seventh) permits a bank to make loans secured by leases).

(Bank Holding Companies),[10] subject to a handful of narrowly defined exceptions.[11] However, the BHCA definition of a "bank" is limited to institutions that are either FDIC-insured or both accept demand deposits and makes loans.[12] In general, Bank Holding Companies are prohibited from engaging in commercial activities.[13] Consequently, issuing charters to nondepositories would permit companies to circumvent the statutory prohibition combining commerce and banking in a single enterprise. Law firms have specifically cited skirting this prohibition as a reason fintechs may seek a charter.[14]

- **The OCC would lack modern statutory authorities to resolve insolvent nondepositories.** As the OCC has acknowledged, "FIRREA [1989] and FDICIA [1991] greatly expanded the FDIC's powers in resolving failed insured depository institutions. The OCC believes that those additional powers are not available to the OCC as receiver of uninsured banks under the NBA."[15] As AFR has previously argued, Congress granted these authorities because they are necessary for the efficient resolution of a modern financial institution.[16] Chartering nondepositories would require the OCC to rely on pre-New Deal authorities that have been dormant for more than eight decades to resolve insolvent institutions.
- **The OCC would lack essential statutory authorities for enforcement against nondepositories and their affiliated parties.** The OCC would lack the fundamental enforcement tools of 12 U.S.C. § 1818, which apply only to depository institutions. These authorities include banning an individual from the banking industry pursuant to § 1818(e) (used by the OCC 12 times in Fiscal Year 2015) and issuing civil monetary penalties pursuant to § 1818(*i*) (used by the OCC 16 times against institutions and 29 times against institution affiliated parties in Fiscal Year 2015).[17] The White Paper does not address

[10] 12 U.S.C. § 1841(c)(1) (2010).

[11] 12 U.S.C. § 1841(c)(2) (2010).

[12] *See* 12 U.S.C. § 1841.

[13] 12 U.S.C. § 1843.

[14] *See, e.g.*, K&L Gates, OCC Explores Special Purpose National Bank Charter for Fintech Companies (Dec. 6, 2016), http://www.klgates.com/occ-explores-special-purpose-national-bank-charter-for-fintech-companies-12-06-2016/#_ednref6.

[15] Receiverships for Uninsured National Banks, 81 Fed. Reg. 62835, 62836 (Sept. 13, 2016); *accord* Receiverships for Uninsured National Banks: Final Rule, 81 Fed. Reg. 92594, 92596 (Dec. 20, 2016).

[16] Americans for Financial Reform, Comment Letter on Proposed Rule for Receiverships for Uninsured National Banks (Nov. 14, 2016), https://www.regulations.gov/document?D=OCC-2016-0017-0012.

[17] Office of the Comptroller of the Currency, Annual Report 28 (2015), https://www.occ.treas.gov/publications/publications-by-type/annual-reports/2015-annual-report.pdf.

how the OCC would have sufficient enforcement authorities for these nondepository institutions without these essential tools.

- **The Community Reinvestment Act (CRA) does not apply to nondepositories.**[18] "The CRA was enacted in 1977 to prevent redlining and to encourage banks . . . to help meet the credit needs of all segments of their communities, including low- and moderate-income neighborhoods and individuals."[19] However, the CRA covers only depository institutions.[20] The White Paper laudably seeks to achieve the CRA's purpose by requiring applicants "to demonstrate a commitment to financial inclusion that supports fair access to financial services and fair treatment of customers."[21] This is an important goal, but without the statutory requirements and authorities of the CRA, its impact is uncertain.

Opening these statutory loopholes is itself a reason for the OCC to decline to issue nondepository charters. However, the inapplicability of these statutes to nondepositories also demonstrates that it is implausible to interpret the NBA to permit the OCC to charter nondepository lenders. It is clear that Congress has repeatedly understood -- with specific, well-defined, and narrow exceptions -- that banks are necessarily depository institutions. Any departure from this requirement necessitates a comprehensive statutory scheme to address the many statutory gaps that would be created by chartering nondepositories.

Prudential, Systemic Risk, And Investor Protection Concerns Involving An OCC Charter

Currently, non-bank fintech firms account for only a very small fraction of the $3.5 trillion U.S. consumer credit market. The two largest digital lenders in the U.S., Lending Club and Prosper, originated only $10 billion in credit in 2015.[22] Even the most optimistic projections of non-bank fintech growth, made before the slower market growth observed during 2016, forecast less than $100 billion in loan volume by 2020.[23] While the use of technology in financial intermediation will no doubt continue to grow, much additional growth in "fintech" will likely occur through the development of new products and delivery systems by traditional banks, including those already

[18] 12 U.S.C. § 2902(2) (2010).

[19] Office of the Comptroller of the Currency, *Community Reinvestment Act (CRA)* (March 2014) https://www.occ.gov/topics/community-affairs/publications/fact-sheets/fact-sheet-cra-reinvestment-act.pdf.

[20] 12 U.S.C. § 2902(2) (2010).

[21] White Paper at 12.

[22] U.S. Department of the Treasury, "Opportunities and Challenges in Online Marketplace Lending," May 10, 2016. Available at https://www.treasury.gov/connect/blog/Documents/Opportunities_and_Challenges_in_Online_Marketplace_Lending_white_paper.pdf

[23] Autonomous, "Digital Lending: the 100 billion dollar question," Jan. 2016, http://collaboratecorp.com/wp-content/uploads/2016/02/AUTONO-FINTECH-Digital-Lending-Jan-2016.pdf

chartered by the OCC and other regulators. The size and significance of other non-bank fintech business models proposed for charter inclusion, such as digital currencies and payment systems, are not as readily quantifiable but also appear to be small at present.

In light of the limited size of the non-bank fintech sector, disruptions in the sector such as the large default losses experienced by Prosper in 2006-2008 and the recent revelations of problematic and deceptive practices at Lending Club have not had broader impacts on the financial system. These incidents have caused losses for the investors involved but the overall economic effects have been limited. Private market investors have increased scrutiny of non-bank fintech firms in response to concerns about business practices, evidence that market discipline has so far been fairly responsive in limiting systemic risk concerns.

This may change if the fintech sector grows significantly. Such growth could be spurred by any implication that fintech business models such as peer to peer or platform lending are within the public safety net or receive public support - an implication that may be created by granting a federal bank charter. Such a charter would not grant deposit insurance to non-depository institutions. However, it would give fintech companies chartered as special purpose banks access to the Federal Reserve discount window through their required membership in the Federal Reserve System. A specialized OCC bank resolution process, depending on how rules are set out, may also create the impression that investors will get more favorable treatment in resolution of a fintech classified as a special purpose bank than they would in an ordinary commercial bankruptcy.[24] Finally, the preemption of state law created by a special purpose charter (as discussed above) will also likely spur growth in the sector.

Thus, any decision to grant a special purpose charter could greatly increase the stakes for proper risk management in the fintech sector, and lessen the effectiveness of market discipline, increasing the likelihood of large-scale systemic fallout or investor losses due to failures in risk management or deliberate fraud.

Effective regulation and supervision of the sector could counter these risks. The White Paper commits to such regulation in a number of areas, including capital, liquidity, and business planning. However, we are concerned that the plans for risk management requirements and oversight in this document do not reflect the range of types of financial activities the OCC proposes to include within the scope of "banking" and to supervise as chartered entities. Traditional forms of bank regulation such as capital and liquidity regulation will not fully address the types of investor and customer protection risks that will be brought under OCC supervision by the types of special purpose charters proposed here. There is little indication in the White Paper that the OCC is on a path to developing a framework of regulation and supervision to fully address the specific risks posed by fintech companies. There is also little evidence that the OCC has coordinated with other regulatory agencies whose supervisory authority might be implicated, or engaged with the Financial Stability Oversight Council (FSOC) to examine important cross-cutting issues. Importantly, the preemption of state regulatory

[24] Americans for Financial Reform, Comment Letter on Proposed Rule for Receiverships for Uninsured National Banks (Nov. 14, 2016), https://www.regulations.gov/document?D=OCC-2016-0017-0012.

authority created by a national bank charter will also lessen the ability of state regulators to take action against abuses by fintech companies.

We are also concerned that the OCC has not accounted for the risks that may emerge from the lack of any Federal consolidated authority over the parent company and affiliates of a fintech company that does not qualify as a "bank" under the Bank Holding Company Act.

Below, we discuss these issues in more detail.

Fintech Companies and the Bank Holding Company Act

The Bank Holding Company Act (BHCA) was enacted because bank supervision can become ineffective without appropriate supervision of the larger holding company that owns a bank. However, the White Paper proposes to charter fintech companies as banks that would not qualify as "banks" under the BHCA definition of that term. As discussed above, this decision threatens to undermine the division between banking and commerce that is central to U.S. banking law.[25] From a prudential supervision perspective, it means that neither the OCC nor the Federal Reserve would have any supervisory authority over the company that owned such a special purpose bank, or over non-bank affiliates of the special purpose bank.

The lack of consolidated supervision over the holding company of the bank could mean that risks emerging in unregulated affiliated entities could impact the bank, or that practices could evade OCC supervision through interaction with unregulated affiliated entities. For example, capital requirements could be rendered ineffective if affiliated entities were undercapitalized and solvency issues at such affiliated entities affected the bank. If payment commitments at unregulated affiliated entities drew on funds from the bank then liquidity supervision could be undermined as well.

There is some potential to address these issues through regulation of the banking entity, including expansive definitions of off balance sheet transactions and tight enforcement of Section 23A and 23B of the Federal Reserve Act. In this context it is useful that the White Paper mentions capitalization of off-balance-sheet activities, although few details are given. However, we are concerned that the potential for a complete lack of regulatory authority over the parent company of the bank or its non-bank affiliates will place extraordinary pressure on supervisory mechanisms limited to the banking entity. Such pressure would include the possibility of legal challenge to an expansive definition of off balance sheet transactions that implicated affiliate or parent activities, as well as the lack of supervisory transparency for affiliate or parent activities. The experience of the 2008 financial crisis showed many examples of risks emerging in affiliated non-bank entities and holding companies which had major negative effects on bank subsidiaries, and the Federal Reserve has significantly altered its consolidated supervision practices in response to the lessons learned from the crisis.

[25] Note 11 & accompanying text, *supra*.

Fintech Companies and Investor Protection Risks

Traditional bank regulation focuses on protecting depositors (and by extension the Deposit Insurance Fund) and not investors. The assumption behind capital regulation is that equity investors are sophisticated, diversified, and prepared to take significant losses to protect depositors. However, nondepository fintech lenders are funded by investors (including peer-to-peer lenders), not deposits. There can be significant transparency and complexity issues for investors in understanding the risks they are exposed to.

The most obvious case is peer-to-peer online lending platforms, which are by definition funded entirely by frequently unsophisticated retail investors. These investors provide full funding for loans, rely on the platform for any in-depth screening or underwriting information, and can be entirely exposed to the default risk of the loan. A simple “capital requirement” will not protect such retail investors as they are the providers of the capital. Depending on its business model, a peer to peer platform could argue that it is 100% capital funded and thus solvent at all times, while engaging in fraudulent or deceptive business practices that led to large-scale loan defaults and large losses of investor capital.

In other cases, online lending platforms do not rely on “peer” funding from ordinary retail investors, but rely on equity investment or institutional lending provided by hedge funds, institutional investors, or securitization markets. Many of these funders are more sophisticated than retail investors, but they may also be vulnerable to deception. The Securities and Exchange Commission (SEC) is currently investigating Lending Club for possible deceptive or fraudulent practices with respect to such sophisticated funders.

The events of the subprime mortgage crisis also demonstrate the ways in which securitization of illiquid assets can create opaque securities whose risks are not fully disclosed by issuers or well understood by even supposedly sophisticated purchasers. Many platform lenders are funded through securitization, and may in effect be simply the origination front end for the generation of loan securitizations. The subprime mortgage experience shows the danger of poor underwriting on individual loans that are then packaged into securities.

Liquidity regulation will not fully address these issues, since it is designed to ensure liquidity sources are available on a temporary basis and will not address permanent losses created by poorly underwritten loans to insolvent borrowers.

In light of these issues, it is disturbing that the OCC white paper nowhere mentions any supervision of loan underwriting or loan quality, or even regulatory efforts to provide greater transparency or protection against deception for investors. Granting of a federal charter to fintech entities is likely to create the impression of greater protection for investors than in fact exists under the rules outlined in the White Paper. While the SEC has the power to pursue cases of investor fraud and deception, such enforcement generally takes place after losses have already occurred.

Fintech Companies and New Types of Customer Risks

All banks have customers, and all banks are regulated for consumer protection to better serve their customers. The White Paper appropriately states that chartered entities will be supervised for compliance with OCC consumer protection rules. It also notes that fintech companies are already subject to the jurisdiction of the Consumer Financial Protection Bureau, regardless of whether a bank charter is granted.

However, the White Paper proposes to charter special purpose banks which will be providing customer services that go far beyond the traditional scope of consumer protection rules. Indeed, the White Paper implies that an extraordinary range of financial activities could form the basis for a special purpose bank charter. For example, the paper appears to imply at various points that technology companies specializing in payment systems, digital currency, distributed ledger technology, automated financial planning ("robo-advisors") or even high-frequency automated trading in debt securitizations could all qualify for OCC special purpose banking charters.[26]

The practices of companies such as these, and their relationship with their customers, could have major implications for systemic risk, cybersecurity, and market integrity across the entire range of the U.S. financial system.

We realize that the OCC already deals with these types of issues as part of its supervision of the largest national banks, which engage in a very wide range of market activities. However, we are concerned that the decision to charter companies creating core financial technology infrastructure as "banks" may have unintended consequences and may further complicate the already confusing regulatory arrangements for oversight of these activities.

For example, customers dealing with a digital currency company that is federally chartered as a bank may draw incorrect conclusions about U.S. government support for such a currency. Indeed, the fact that such a digital currency company would have access to the Federal Reserve discount window might legitimate such conclusions.

Chartering payment systems companies as banks would appear to complicate Federal Reserve supervisory authority over U.S. payment systems as a whole. Chartering distributed ledger technology providers as banks could make the OCC the direct supervisor of settlement or clearing systems for securities transactions. Chartering financial planners as banks could lead to both the OCC and SEC acting as the supervisor of investment advisors or investment companies. While the additional supervision of such entities could be beneficial if properly designed, it does not appear that there has been in-depth coordination and consultation with other financial

[26] Digital currency companies, distributed ledger companies, and automated financial planners are referenced in an introductory paragraph on page 2 of the White Paper that discusses the benefits of applying OCC supervision to fintech companies. Payments systems companies and companies dealing in debt securitizations are referenced in a paragraph on page 4 of the White Paper that discusses the types of activities the OCC views as clearly included within banking activities under the National Bank Act.

regulators that also have regulatory expertise in the oversight of the range of activities that could be implicated in charter decisions.

* * *

Your consideration of these comments is appreciated. For questions, please contact Marcus Stanley, Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672, or Brian Simmonds Marshall, Policy Counsel, at brian@ourfinancialsecurity.org or (202) 684-2974.

Sincerely,

Americans for Financial Reform