Should Your Fintech Company Apply for an OCC Charter

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Activities of a National Bank

- OCC can charter a bank only if it does one of the following three things:
  1. receive deposits,
  2. pay checks (may be through issuing debit cards, or engaging in other means of facilitating payments electronically), or
  3. lend money (may be through discounting notes, purchasing bank-permissible debt securities, or engaging in lease-financing transactions or making loans)

- Senate Democrats have raised the issue of whether the OCC has the power to charter limited purpose fintech banks.

Advantages of an OCC Charter

- Ability to export interest rates of home state pursuant to Section 85
- Preemption of state law (e.g., state interest rate limits) per Barnett Bank decision (12 USC 25b) and limits on state visitorial authority:
  1. preemption of state consumer financial laws if
     a) state law has a discriminatory effect on national banks, in comparison with the effect of the law on a bank chartered by that state,
     b) state law would prevent or significantly interfere with the exercise of the national bank of its powers, or
     c) preemption through some other Federal law.
     d) other state laws continue to apply
- Access to payment systems as a member bank of the Federal Reserve

Pre-filing meeting with OCC

- Describe the proposed activities in a “robust” 3 year business plan
- Provide biographical information about directors and CEO and the composition of the management team
- Discuss insider transactions/conflicts of interest summary
- Discuss capital (Tier 1 leverage ratio of at least 8%) and subscription information
- Meeting is private to allow a free flow of information without concern about public disclosure
- No time limits on filing

Application Filed

- Publish public notice
- Identify directors and CEO
- File fingerprint cards, IRS waiver forms, personal financial and biographical data
- Specify location
- File a business plan
- Explain the compensation structure
- Submit insider transaction policy, describe proposed contracts and arrangements and related “fairness”
- Clock starts on process

Application Complete

- OCC sends a letter of completed application
- OCC conducts a field investigation
- OCC comments about these factors:
  1. Chances for success,
  2. Safe and sound operation,
  3. Providing fair access, promoting financial inclusion, protecting customers, supporting communities, fairly treating customers, and the capital adequacy for the proposed risk profile (tiered capital injections disfavored).

Preliminary Conditional Approval

- OCC sends a letter with conditions enumerated (including 12 months to raise capital, 18 months to open)
- OCC seeks near finalization of these documents and aspects of operation:
  1. Third-party risk management program
  2. Operating agreement with OCC
  3. Contingency business plan agreement with OCC
  4. Capital, capital structure and liquidity (access to funds, cost of funding liquidity, contingency funding plans), off-balance sheet activity
  5. Corporate governance, internal controls (including modeling), operations and affiliate relationships

Organizational Phase

- Bank premises
- Internal audit system
- Shareholders' meeting, directors' meetings
- Annual independent external audit for at least three years
- Fidelity insurance carrier, other insurance carriers

Preopening Examination

- OCC sends examiners for these purposes:
  - Physically inspect the premises
  - Review bank systems
  - Determine if there have been any significant changes to, or deviations from, the business plan from that submitted earlier to OCC

Final Approval

- Applicant must demonstrate that it will be able to assure compliance with
- Fair lending laws-if applicant is a lender (e.g., TILA, RESPA, HMDA, ECOA, FCRA, FHA, SCRA)
- Restrictions on unfair or deceptive acts or practices under Dodd-Frank and Section 5 of the FTC Act
- BSA/AML/OFAC
- Cybersecurity

Financial Inclusion (CRA Lite)

- Any applicant that will engage in lending must demonstrate a commitment to financial inclusion (defined in fn. 30 to the Dec. 2016 OCC paper on *Exploring Special Purpose National Bank Charters for Fintech Companies*
- "access to useful and affordable financial products and services that meet their needs–transactions, payments, savings, credit and insurance–delivered in a responsible and sustainable way"

Post Opening

- Independent audits for at least three years
- Ongoing examination and supervision and payment of OCC assessments
- Notice and prior approval needed before any change of, or deviation from, the business plan
- CFPB is also a regulator if applicant is insured and has more than $10 billion in assets. If applicant already offers or provides origination, brokerage, or servicing of consumer mortgage, payday or private education loans, then that applicant is already subject to CFPB jurisdiction for those activities.

Approval Conditions

- Conditions for approval are likely to include the following:
  - Activity restrictions
  - Capital in excess of the minimum amounts required by the OCC's capital rule (12 C.F.R. Part 3)
  - Prior notice and no objection for any significant deviations from business plan
  - Review and approval of the bank's proposed information security architecture
  - Independent information security review
  - Comprehensive Contingency Funding Plan
  - Model Risk Management Plan

Approval Conditions

- Unlike special purpose credit card banks and trust banks, which were created by the Competitive Equality Banking Act of 1987, the activities of a special purpose fintech bank would not be determined by federal statute. *See*, 12 U.S.C. 1841(c)(2)(D) and (F)

- "There is no legal limitation on the type of 'special purpose' for which a national bank charter may be granted so long as the entity engages in fiduciary activities or activities that include receiving deposits, paying checks, or lending money." OCC Fintech Proposal (December 2016), p. 3.

Baseline Supervisory Expectations

- Robust, well-developed business plan:
  - Cover at least three years
  - Define the bank's products and services and market
  - Must fully describe actions needed to accomplish the bank's primary business objectives
  - Include forecasts of future market demand, economic conditions, competition, and the bank's customer base
  - Demonstrate "a realistic assessment of risk"
  - Describe capital support in detail, including available sources for bolstering capital levels in a liquidity crisis
  - Address best-case and worst-case scenarios

Baseline Supervisory Expectations

- Governance structure:
  - Reflect the bank's products, services, and activities
  - Describe the risk management systems relied upon to identify, monitor, manage, and control risk
  - Ensure the timely and regular delivery of adequate, accurate, and current information for measuring and monitoring applicable risks
  - Include methodologies for performing risk analyses
  - Provide a "prominent role" for the Board of Directors

Baseline Supervisory Expectations

- Capital:
  - Must be commensurate with the risk and complexity of the bank's activities
  - OCC will consider both qualitative and quantitative
  - Qualitative factors include the scope and nature of activities, quality of management, funds management, ownership, operating procedures and controls, asset quality, earnings, risk diversification, and strategic planning
  - A specified minimum level of capital must be maintained at all times

Key OCC Guidance

- Examination Procedures (OCC and CFPB)
- OCC Handbook: Bank Supervision Process
- OCC Director's Handbook
- OCC Bulletin 2011-12, Supervisory Guidance on Model Risk Management
- OCC Bulletin 2004-20, Risk Management of New, Expanded, or Modified Bank Products and Services
- OCC Bulletin 2013-29, Third Party Relationships: Risk Management Guidance
- OCC Bulletin 2012-23, Community Bank Stress Testing: Supervisory Guidance
- OCC Bulletins 2005-35 and 2011-26 (Supplement), Authentication in an Internet Banking Environment
- OCC Bulletin 2013-23, Regulatory Capital Rule
- Interagency Guidelines Establishing Information Security Standards (12 C.F.R. Part 30, Appendix B)

Examination

- Field Investigation
- Initial Limited Onsite Exam (approximately 60 days after conditional approval)
- Initial Full Scope Onsite Exam (approximately six months after conditional approval)
- All national banks are required to receive at least one full-scope, onsite per year
- OCC supervisory offices have the discretion to conduct exams more frequently, including if potential or perceived deterioration in the bank's condition requires prompt attention

A Case Study In What Could Go Awry:

- Next Bank N.A.
  - In May 1999, NextBank became second Internet-only bank to receive a special purpose charter from the OCC
  - NextBank was a credit card bank that featured a proprietary, online credit application, authentication, and underwriting process which allowed applications to be processed in approximately 30 seconds
  - Prior to applying for a bank charter the organizers of NextBank had issued cards under a bank partnership arrangement
  - NextBank's business plan was heavily dependent on rapid asset growth
  - In February 2002, the OCC ordered NextBank to cease operations in order to prevent the bank from becoming critically under-capitalized

See, *U.S. Office of the Inspector General Report, Material Loss Review of NextBank, N.A.*, November 26, 2002.

Keys to Success

- Knowledge:
  - Application process
  - Legal and regulatory requirements
  - OCC Bulletins and other guidance
  - Supervisory process
- Experience
- Perseverance
- Flexibility
- Financial Resources

George A. Popescu

OCC Fintech Charter's value depends on the origination volume

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Community Bank costs

- **Setup: $2mil**
- **Basel III: 4.5% of common-equity of risk-weighted assets. $20mil -> $444mil**
- **6000 community banks in the US**. Cost of ongoing compliance: $4.5bil per year. =>$750,000 per bank per year
- **Compliance cost growing at $100,000 per year**

1st 5 years cost

0. The same costs they have right now plus
1. $20mil in net capital
2. $2mil 1st year operating costs
3. $3,600,000 (the cost of annual compliance, taking into account the $100,000 per year increase).

Total: $5.6mil

FDIC bank partnership

- 0.5% origination fee (+monthly minimum)
- $5.6mil => $1.12 bil in origination over 5 years

Discussion

- FDIC bank partnership : volume discount
- Increase of net capital above $20mil
- Rough calculations
- Intangibles : independence, increase in control, true lender issues solved…

Questions & Answers

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- Former chairman of the firm's Financial Services Practice Group from 2003 to 2015.
- Transactional practice focuses on representing financial institutions, corporations and other entities in complex financing transactions, including mergers and acquisitions, asset securitizations and other lending and venture transactions.
- Also represents non-depository institutions and specialty finance companies, and service providers in compliance matters, payment system issues, strategic transactions, government investigation and enforcement actions.

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- Has over 25 years of broad-based experience in financial services law and consumer and regulatory compliance.
- Career includes extensive experience in consumer lending, safety and soundness, and anti-money laundering.
- His work in consumer and regulatory compliance at large financial institutions has been marked by innovations that resulted in fundamental structural changes to existing firm-wide compliance activities.
- Former OCC senior counsel.

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Editor in Chief and Founder of Lending Times

- *Lending Times*
  - News, Analysis and Data for p2p and marketplace lender
  - 15000 visitors per month
  - 10000 daily newsletter readers
- Entrepreneur
  - Built 11+ companies
  - 8 of which exited successfully or closed with a profit
  - Founder, CEO, hands on, involved with all aspects
  - Built #1 fastest growing company in Boston
  - Inc 500/5000 4 years in a row

BACKED INC.

- Co-founder and ex-CEO
- Personal loan originator
- Marketplace Lender

LunaCap Ventures

Partner

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- Represented dozens of clients before the federal bank regulatory agencies, the U.S. Securities and Exchange Commission, and various state banking and securities regulators across the country.
- Former counsel with the OCC in New York, where he negotiated enforcement documents, participated in bank examinations, coordinated action with Federal Reserve and FDIC staff, and provided advice regarding supervision of banks, federal branches and agencies, and trust banks.

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Locations

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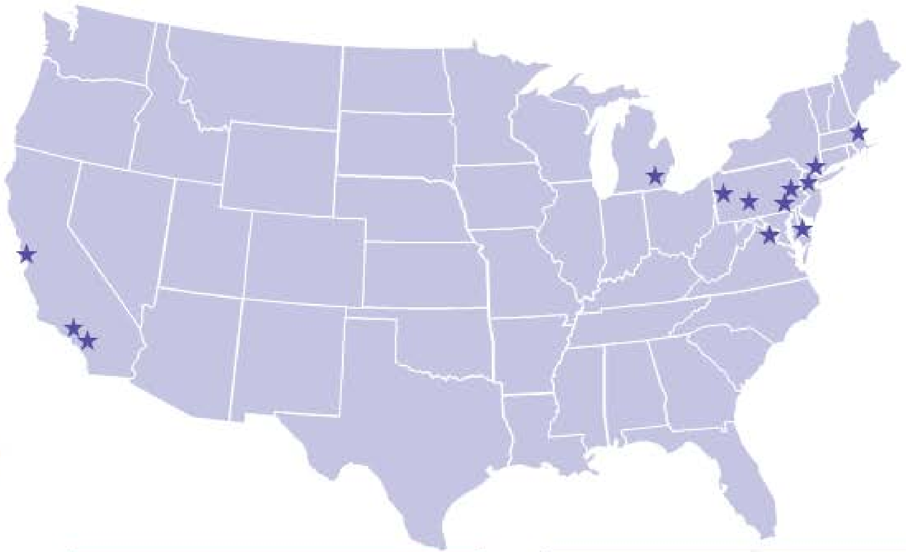

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