

Consumer Finance Monitor (Season 3, Episode 32): A First Look at the Plans of the Office of the Comptroller of the Currency for a National Payments Charter

Speakers: Alan Kaplinsky, Scott Coleman, and Mindy Harris

Alan Kaplinsky:

Welcome to the Consumer Finance Monitor Podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. I'm your host today, Alan Kaplinsky, and I chair the Consumer Financial Services Group at Ballard Spahr, and I'll be moderating today's program for those of you who want even more information about various consumer financial services developments and the topic that we're going to be discussing in some depth today, don't forget to look at our blog, which is also called consumerfinancemonitor.com. We've hosted that blog ever since the CFPB got stood up in 2011, and then the name of the blog change from CFPBmonitor.com to Consumer Finance Monitor after the last presidential election. So, we now cover the waterfront when it comes to consumer financial services. You can subscribe to our blog on the blog itself.

Alan Kaplinsky:

And also, don't forget our webinars. We do probably 35 to 40 a year. This year in light of the pandemic and the fact that very few, if any, of us are able to attend live programs, we have upped our game. We're doing many more webinars now than we have in prior years. In terms of our podcast, it's available on our website, or you can get it on Apple Podcasts, Google Play, Spotify, or wherever you regularly download your podcasts.

Alan Kaplinsky:

Now, let me tell you what our topic is today, and then I'm going to introduce our guests for today. So, very recently, the comptroller of the currency, Joseph Otting, resigned before the end of his term. I guess it was Treasurer Mnuchin appointed as the acting comptroller of the currency, Brian Brooks, who I happen to know very well. I've known Brian for years when he was in private practice with O'Melveny and Myers. He was a class action defense litigator. He left that position at one time to go with OneWest Bank where Joseph Otting worked, as well as Steve Mnuchin. And then, from there, after that bank was sold to CIT, he went into government, worked in government for a while. Then he worked for a cryptocurrency company called Coinbase, and now has taken the position as acting comptroller of the currency.

Alan Kaplinsky:

And knowing Brian as well as I do, it's a breath of fresh air. He's very much a techie as well as a very fine lawyer, and he already has made his mark by focusing on technology. And one of the ideas that he proffered very soon after assuming office was this idea of a new payments charter for a national bank, and he has spoken about it on a few occasions. And I would imagine that sometime in the next several months, we'll see something more formal emanating from the OCC.

Alan Kaplinsky:

So, let me introduce to you our speakers today. First, Scott Coleman. Scott is a partner in our Minneapolis office, and he represents banks and bank holding companies in connection with mergers, stock purchase transactions, branch purchase and assumption transactions, capital raising, corporate restructuring, branching, non-bank acquisitions, changes in bank control, and charter conversions. He's also represented organizers seeking to form bank holding companies to apply for deposit insurance and charter new depository institutions. Scott has significant experience in a wide range of regulatory matters, including Reg O, Reg W, Reg Y, interstate banking and branching, lending limits Basel III capital requirements, and regulatory

capital guidelines. And he also represents bank stock lenders and subordinated debt purchasers. As I often say, he is a real banking lawyer. He's not just a consumer financial services lawyer.

Alan Kaplinsky:

And then, I want to also introduce Mindy Harris. Mindy is the latest lawyer to join our consumer financial services group. Mindy joined us, indeed, during the pandemic and hasn't yet had an opportunity to work out of her Denver office, but that's where Mindy will reside once we're all able to go back and work in our offices. Mindy has decades of experience as a consumer financial services lawyer, with a background as working as general counsel to financial services companies. She's proficient in analysis and application of law and regulation, while maintaining a focus on achievement of business goals. Prior to joining us, Mindy was managing director and general counsel for Auriemma Roundtables and Auriemma Group. And she, prior to that, was senior vice president and general counsel for Nordstrom Bank, a federal savings bank that was owned by the luxury retailer, Nordstrom Inc. So, let me welcome both you, Scott, and you, Mindy to our show today.

Scott Coleman:

Thank you very much, Alan.

Mindy Harris:

Thank you, Alan.

Alan Kaplinsky:

So, let's get into it right now. And the format today is I'm going to be asking a number of questions of Scott and Mindy, and on several of the questions, I'm sure they're both going to chime in. So, let's start at the beginning, Mindy. In recent interviews, Brian Brooks, the acting comptroller of the currency has been talking about the OCC's plans to offer this additional special purpose national bank charter. What is the purpose of this new national bank charter, Mindy?

Mindy Harris:

Alan, it's very interesting. As you said in recent weeks, Acting Comptroller Brooks has been talking about a new type of charter to be offered by the OCC, a national payments charter that would replace for money transmitters and payment processing companies the necessity to be licensed on a state by basis. And Acting Comptroller Brooks points out that this would give non-bank payment processing companies a nationwide servicing platform and federal preemption of state laws regarding licensing of money transmitters and regulation of payment services providers.

Alan Kaplinsky:

Is this intended, Mindy, to entirely replace the existing approach where companies obtain non-bank companies that are in the payments business, where they obtain money transmitter licenses from numerous states and, in some cases, all 50 states?

Mindy Harris:

It's a good question, Alan, and I think the likely answer, at least in the first instance, assuming the OCC successfully establishes a national payments charter, that this would be another alternative for payment processors. Some might really want to embrace a federal platform, a national charter. Others might want to stick with the state licensing approach, and so that's similar, in many ways, to the dual banking system where some banks want a state charter and others want federal charters.

Scott Coleman:

Keep in mind, Alan, that there are a lot of unknowns about the payments charter that could cause a processor to prefer to operate under a state licensing regime. For example, what capital levels will the OCC require? What will the examination

framework look like? What Community Reinvestment Act responsibilities will be imposed? How long will an application take? A processor that has sought licensing from states where it does businesses may prefer not to switch at this time.

Alan Kaplinsky:

So, Mindy, or Scott, let me go to you first, can you provide more detail about the OCC's plans?

Scott Coleman:

Sure. Acting Comptroller Brooks proposed a two phase rollout. First would start what he called payments charter 1.0, which is basically a national money transmitter license. Now, keep in mind that applications for state money transmitter licenses can be daunting. In most cases, the applications are filed through the NMLS system, but the requirements are not uniform amongst the states and annual renewals are required. Our licensing attorneys have helped a number of fintechs obtain state licenses, develop a process for assembling the information, organize the information and filed it, but whether licenses are sought in all 50 states or just a portion of the states, it is a very expensive and time-consuming process. So, a national license that afforded preemption of state laws would be very attractive.

Alan Kaplinsky:

Yeah. Mindy, you want to chime in?

Mindy Harris:

Well, I think Scott made an excellent point, and I think it would be something that people who are in this business, and people who want to enter the business, would definitely take note of. So, pursuing your original question and the two phase rollout, Acting Comptroller Books went on to say that once the charter 1.0 has its feet on the ground and has gained some acceptance from others, and I think he also is thinking of other government agencies, he envisions payments charter 2.0. And the distinguishing feature about payment charter 2.0 is that it would provide access for the payment processor directly to the federal reserves payment system. Acting Comptroller Brooks anticipated a legal issue that this might raise, which is that there is language with respect to eligibility to accept deposits in order to support direct access to the fed system, and in the interviews he's had, he has explained the position that because the OCC charter would confer eligibility for FDIC insurance, that he believes it would support access to the fed system even if the chartered entity didn't actually apply for or obtain FDIC insurance.

Mindy Harris:

I also want to touch on a point that I think is really important that Scott mentioned a little bit earlier. The OCC is considering other aspects of the charter, such as what kind of community support and financial inclusion expectations will apply. Now, as we know, CRA, Community Reinvestment Act, formal CRA, is tied to acceptance of deposits, but the OCC acting comptroller made it clear that he's thinking about community support and inclusion requirements. And obviously, he's also thinking about how to make sure that safety and soundness standards are established for entities like this that obtain federal charter status. So, those were really interesting previews for topics, I would say, and the acting comptroller said we're going to be hearing more about it hopefully soon.

Scott Coleman:

Keep in mind, Alan, that nothing prevents a payments business from applying to the FDIC for deposit insurance if its business model included taking deposits. When we talk about the payments charter both in model 1.0 and 2.0, we're talking about an institution or a charter that is not insured by the FDIC. That said, a payments processor could seek deposit insurance. If it did so, it would likely face higher capital requirements. Further, the FDIC's statement of policy on applications for deposit insurance describes limits on how stock is offered by applicants for deposit insurance, it requires a demonstration of profitability within three years, limits the use of leverage, limits the use of leverage by insiders in acquiring their stock. There

would be a lot for a payment processor to think about, but I think we want to differentiate between insured depository institutions and the payments charter, which would be not insured.

Alan Kaplinsky:

Yeah. And in addition to what you've said, Scott, isn't it also true that if a company had applied to the OCC for payments charter, and also sought FDIC insurance, that the company that owns that bank would have to be registered as a bank holding company?

Scott Coleman:

That is absolutely correct. Any company that controls, directly or indirectly, an insured depository institution is deemed a bank holding company and would be subject to examination by the federal reserve and would be subject to the limits, whether it's a bank holding company or a financial holding company, on activities that can be engaged in.

Alan Kaplinsky:

Yeah. And that for, I guess, a lot of companies that want to get into the fintech area or already are in the fintech area and are thinking of converting to this special charter, this could be a problem for them because they're all ready, some of them are private equity companies and they could be engaged in all kinds of activities unrelated to banking. So, getting the FDIC insurance could really be a problem.

Scott Coleman:

That's correct.

Alan Kaplinsky:

And I think that when Acting Comptroller Brooks is talking about this new charter, I think he's probably contemplating that very few of these companies would indicate that they want to accept FDIC insured deposits. Am I right?

Scott Coleman:

I think that's correct. There's a question from a business model perspective of whether or not you're leaving something behind by not having the deposits and being able to invest those yourself, but the penalties of becoming a bank holding company or a financial holding company are significant enough and a limit on your business significant enough that I think the acting comptroller does believe that most applicants for the payments charter, whether it's 1.0 or 2.0, would not seek deposit insurance.

Alan Kaplinsky:

Yeah. And let me ask just one other thing before I circle back to a question I have for Mindy. So, this 1.0 versus 2.0, if you're going to get a 2.0 charter, that gives you access to the federal reserve system, which I think is a nice thing, but it may be an issue because you're going to be arguing to the fed that you're entitled to access to the fed system because you are eligible to get deposit insurance. And yet, you've already told the comptroller in your business plan that you don't have any intention to take insured deposits. Is there a little bit of a inconsistency there?

Scott Coleman:

There is a little bit of inconsistency and there's a lack of clarity. We haven't heard what the board of governors or the federal reserve system feels about this structure. Certainly when we saw, and we'll probably talk a little about the fintech charter proposal that the OCC came out with, there it was conveyed that holders of the fintech charter would have access to the federal reserve system. The fed never said that was absolutely the case. And even then, there's a question of what that means.

Does that mean just overnight borrowings from the discount window? Does it mean you can initiate transactions through the fed system as a clearing house? There's a lot that's unknown at this time about what payments charter 2.0 means.

Alan Kaplinsky:

Yeah. But I take it, Scott, even if that became a problem and the fed didn't want to permit direct access, a 1.0 charter would enable you to deal with another depository institution that does have access to the fed, so you would just work through another institution. Am I right?

Scott Coleman:

Right. That's correct. And if you're not having insured deposits and you're having custody of all these funds in your payments operations, you're still going to need a bank partner at some point in time who's going to hold the funds and ensure depository accounts.

Alan Kaplinsky:

So, Mindy, question for you. What core insights are driving the OCC's development of this payments charter?

Mindy Harris:

That is a really good question, and that actually goes back to your earlier discussion that we just had about what would any of these entities want or need to be deposit taking? Because what the acting comptroller spent a lot of time talking about is unbundling financial services. So, he really envisions a company that does not want to accept deposits, does not want to make loans, and only wants to provide one of the three traditional banking services to customers. He pointed out that he sees, as someone who comes out of the fintech industry, a trend where customers may not want to receive all their financial services from one source. And while he was quick to say for some banks, the traditional model of the three key banking services taking deposits, lending, and paying, or what we used to say paying checks, he sees the evolving needs of financial services customers as supporting a different approach where a service provider focuses on just one of these functions, which in this case would be payment processing.

Alan Kaplinsky:

What would make the payments charter appealing to companies that currently have money transmitter licenses?

Mindy Harris:

That's a good point. We touched on that a little bit at the beginning, and Scott mentioned that the multi-state filing, even though state authorities have tried to interject some sort of uniformity in forms of applications, is still extremely daunting, extremely burdensome, and you are dealing with 50 or, if you're in other jurisdictions, 50 or more separate regulatory authorities. So, this would give the company the ability to follow with an answer to just one licensing authority, which would be the OCC, rather than dealing with multiple jurisdictions in their ability to perform money, transmission functions, at the very least.

Mindy Harris:

Another aspect that the acting comptroller cited is he believes that supervision by the OCC would cause an increase in consumer confidence. He thinks, as a regulator, that the OCC is well thought of, and so he sees that as a benefit that some companies may want to go after.

Scott Coleman:

And of course, as you mentioned, Alan, if they are not an insured depository institution, that is if they do not take and hold deposits, then any owner of the payments charter will not be deemed a bank holding company subject to examination by the

board of governors of the federal reserve system, or one of the local federal reserve banks, and will not be subject to either the limit on non-banking activities that applies to bank holding companies, where they can only engage in listed permissible non-banking activities, or to the activities that a financial holding company might be able to engage in. So, avoiding fed oversight is a key appeal of the charter.

Alan Kaplinsky:

Mindy, how would this payments charter fit in with the comptroller's mission?

Mindy Harris:

The acting comptroller talked about the fact that the OCC's role is to create and support national financial services platforms, so he believes it dovetails very strongly with the entire purpose of the OCC. And he commented that the proposed payments charter would bring companies that offer payment processing services, but not necessarily other banking services, into the national banking system and under the auspices of the OCC.

Alan Kaplinsky:

Question for you, Scott. I've been struggling, in my mind, to figure out the difference between this proposal for a payments charter and Comptroller Otting's proposal from a couple of years ago for the comptroller to charter so-called fintech banks. I guess that was launched in 2018. That became the subject of litigation. The New York Department of Financial Institutions and the Conference of State Bank Supervisors brought two separate lawsuits challenging what Comptroller Otting was doing, and unfortunately, it didn't turn out so well for the comptroller. Am I right, Scott?

Scott Coleman:

Yeah. That is true. And if you ask how the payments charter and the fintech special purpose charter are different, the short answer is that they're not. In May of 2019, the New York federal district court denied the OCC's motion to dismiss a lawsuit filed by the New York Department of Financial Services to block the issuance of the special purpose national bank charter to fintech companies. And in doing so, the court found that the term business of banking as used in the National Bank Act "unambiguously requires receiving deposits as an aspect of the business."

Scott Coleman:

So, here, we have another proposed charter that is limited in the scope, and once again, the proposed charter will not receive deposits. If the New York federal district court was correct in its analysis, and keep in mind that Ballard Spahr does not believe that the decision which the OCC has appealed was correctly decided, then the payments charter would have the same issues. I would ask that if you want to read more about that case, that you search fintech charter at consumerfinancemonitor.com, and you can read a blog post that our colleague Jeremy Rosenblum wrote that discusses the arguments advanced by the OCC in the appeal to the second circuit. As the OCC's brief points out, deposit taking is not required for a national bank charter. For example, trust banks.

Mindy Harris:

It's true, Scott, that the charter legally, technically may not be different from the fintech charter as proposed. However, as described, it's a different flavor because the payments charter, the way Acting Comptroller Brooks talked about it, has a narrower scope than the fintech charter and does not include lending authority. So, even though it's very similar in structure, the fact that lending authority appears to be off the table for this type of charter, it wouldn't raise the controversial issue of interest rate exportation under section 85 that seems to be the lightning rod attracting a lot of, at least, consumer advocacy group concerns about the FinTech charter. But I think you're absolutely right, there still may be legal challenges to the charter because of the federal district court's order, and that is just going to have to be resolved on appeal in the second circuit, I agree, before this payments charter could take off.

Alan Kaplinsky:

So, Mindy, would a new administration, following the 2020 election, derail this charter?

Mindy Harris:

Alan, if Biden is elected and names a different comptroller who doesn't support this approach, that could derail this charter effort. However, it could be argued that the narrow payments charter is not a situation like a broader fintech charter, where support for the charter should break along party lines. A national payments charter acknowledges the role that technology is playing in reshaping the financial system, and clearly, it could be argued that it may make financial services more available to low and moderate income individuals, having federal regulatory oversight over payment companies by the OCC and, in particular, giving payment companies CRA-type community support requirements, which is not done at state level right now, might be perceived by both parties as beneficial.

Alan Kaplinsky:

What other challenges does this payment's charter face?

Mindy Harris:

Alan, the payment charter, I think, is likely to be challenged by state money transmitter licensing authorities that would not want to lose those licensing revenues and the control that they have over the activities of these companies. It might be opposed by insured depository institutions that might view a new type of institution as a threat. Although, as Scott pointed out earlier, if it's payments charter 1.0, that charter is probably still going to have to partner with a depository, so it may not be a threat. And it could be challenged by consumer groups. However, because the charter entities would not be seeking lending powers, interest rate exportation is not a part of this charter, and concerns about consumer harm, much less likely. In fact, there are many aspects of the proposal that realistically should be supported by consumer groups, since it adds community support and inclusion responsibility where none exists now, to my knowledge, under any state money transmitter licensing regimes, and arguably stronger OCC safety and soundness components.

Scott Coleman:

The OCC could also win the battle and lose the war. It's possible that even if it was successful in granting a payments charter, that the breadth of federal preemption over state licensing and visitors powers would be litigated. It's not clear that federal preemption would extend fully in this case and would likely be an issue tied up before the courts for years to come. Further, if the OCC's fintech charter prevails, the need for the payments charter is moot. We will already have a special purpose national bank charter that is available for payments, businesses, and other fintechs. If the OCC is held not to have the power to grant a fintech charter, the payment charter likely suffers from the same problem that it doesn't take deposits. Keep in mind that the payments charter is not the be all and end all for the payments company. It is useful if it can help avoid state licensing requirements, but a payment processor will still need an insured depository institution as a partner to hold custody of its funds.

Alan Kaplinsky:

And Scott, is there any other charter or structure a payment processor should consider if they want to own a bank?

Scott Coleman:

Yes, there is, Alan. The FDIC has waded into the fray recently, approving earlier this year two deposit insurance applications for industrial loan companies. This development needs to be watched closely. I said earlier that any entity that owns an insured depository institution would be regulated as a bank holding company. That's true in all but one case. An entity that owns an industrial loan company is not deemed to be a bank holding company and is not regulated by the federal reserve board of governors or a local federal reserve bank. That makes that charter intriguing. Now, a discussion of the full advantages and disadvantages of an industrial loan company charter is beyond the scope of this podcast, and on March 6th, the FDIC issued for comment to propose rulemaking that would subject a new parent company of an industrial loan company to certain

restrictions, and require the parent company to make certain commitments that could make this charter less attractive. But it remains an intriguing structure for payment processors and other fintechs. We have experience forming industrial loan companies in Utah and other states, and this is a development that we are watching very carefully.

Alan Kaplinsky:

Okay. So, we've drawn to the end of our podcast today. I want to thank my guests, Scott Coleman, Mindy Harris, and I certainly want to thank all of our listeners today who downloaded our podcast. Make sure to visit our website where you can subscribe to the show on the website or in Apple Podcasts, Google Play, Spotify, or whatever your favorite podcast platform may be. And don't forget to check out our blog, Consumer Finance Monitor, for daily insights of the consumer financial services industry. Once again, thank you for listening today.