MERCATUS CENTER
George Mason University

Bridging the gap between academic ideas and real-world problems

PUBLIC INTEREST COMMENT

RESPONSE TO THE OCC'S PROPOSED CHANGES TO THE LICENSING MANUAL REGARDING CHARTER APPLICATIONS FROM FINTECH COMPANIES

BRIAN R. KNIGHT
Senior Research Fellow, Mercatus Center at George Mason University

Comptroller's Licensing Manual Draft Supplement: Evaluating Charter Applications from Financial Technology Companies
Agency: Department of the Treasury, Office of the Comptroller of the Currency
Draft Released: March 15, 2017
Comment period closes: April 14, 2017
Submitted: April 14, 2017

Thank you for the opportunity to comment on proposed amendments from the Office of the Comptroller of the Currency (OCC) to the Comptroller's Licensing Manual regarding evaluating charter applications from fintech companies (the proposal).[1] The Mercatus Center at George Mason University is dedicated to bridging the gap between academic ideas and real-world problems and to advancing knowledge about the effects of regulation on society. This comment, therefore, does not represent the views of any particular affected party or special interest group, but is designed to assist the OCC in creating a regulatory environment that will facilitate increased innovation, competition, and access to financial services to the benefit of the public.

INTRODUCTION

The OCC has proposed[2] amending its licensing manual to allow non-depository fintech companies that lend money or facilitate payments to become special purpose national banks (SPNBs).

1. Office of the Comptroller of the Currency (OCC), "Comptroller's Licensing Manual Draft Supplement: Evaluating Charter Applications from Financial Technology Companies," March 2017.
2. OCC, "OCC Issues Draft Licensing Manual Supplement for Evaluating Charter Applications from Financial Technology Companies, Will Accept Comments through April 14," March 15, 2017.

For more information, contact
Chad Reese, Assistant Director of Outreach for Financial Policy
703-993-8921, creese@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Boulevard, 4th Floor, Arlington, VA 22201

The proposal lays out requirements prospective SPNBs will need to meet to obtain and maintain a charter, and it provides details on the charter application process. The OCC has solicited comment on the proposal. In response, this letter evaluates some aspects of the proposal and suggests improvements the OCC should consider to help the chartering effort achieve its stated goals of providing greater access to higher-quality financial services and strengthening the national banking system, while ensuring appropriate systemic and customer protection.

The OCC should be commended for its efforts to embrace innovation. The OCC should also be praised for its efforts to engage with interested parties and solicit comment from the public as its work has progressed. While the present proposal benefits from those efforts in some areas, it unfortunately remains ill fitting and overly burdensome in others.

The promise of a fintech charter is that it will allow innovative, nimble companies that use technology to provide competitive products and expand access to underserved groups. These firms, by virtue of being non-depository, may also create less risk to taxpayers and customers compared to traditional banks and present different considerations regarding customer protections and safety and soundness.

While the OCC's current proposal shows some improvement over its previous statements,[3] it remains overly focused on the survival of the entity instead of the protection of customers. It also explicitly and implicitly imposes requirements and conditions on SPNBs that many will find impossible to meet—without a sufficient countervailing benefit. Finally, while the proposal provides more specificity than previous statements, it is still too vague.

To address these issues I recommend that the OCC:

- Reorient charter requirements away from insisting that SPNBs demonstrate survivability and toward ensuring that SPNBs can fail in an orderly manner that protects their customers.
- Clarify the requirements for SPNBs to obtain and maintain a charter consistent with the rights and responsibilities of national banks under relevant law.

I discuss each of the recommendations in turn. In addition, I have attached a previous letter I authored with Hester Peirce and J. W. Verret,[4] which I wish to include for reference.

THE OCC SHOULD FOCUS ITS REQUIREMENTS ON ENSURING FIRMS CAN PROTECT CUSTOMERS IN THE EVENT OF FAILURE, RATHER THAN PREVENTING FIRMS FROM FAILING

The OCC is responsible for regulating nationally chartered banks in a way that protects customers, ensures the safety and soundness of the national banking system, and "promotes a

3. OCC, "Exploring Special Purpose National Bank Charters for Fintech Companies," December 2016.
4. Brian R. Knight, Hester Peirce, and J. W. Verret, "Response to OCC White Paper Exploring Special Purpose National Bank Charters for Fintech Companies" (Public Interest Comment, Mercatus Center at George Mason University, Arlington, VA, January 15, 2017).

vibrant and diverse banking system that benefits consumers, communities, businesses, and the U.S. economy."[5] This means that the OCC is responsible for creating a regulatory environment where the interests of the customer, rather than of any particular financial institution or business model, are paramount. It also means that the OCC should be mindful of the risks customers face from a lack of access to financial products and services, not just the risks attendant to their provision.

Non-depository fintech firms present an opportunity to expand access to financial services, lowering customers' risk. They also present different, and likely lower, risks to the banking system as a whole because they do not take demand deposits and do not receive federally backed deposit insurance. In light of this the OCC should not base SPNB regulation on existing depository regulation. The mere fact that depository institutions are regulated in a certain way or face certain requirements is irrelevant if the risks that those regulations seek to address are not present or can be addressed via less burdensome regulation in the context of non-depository SPNBs. The OCC should not seek to make a "level playing field" by mandating unnecessary requirements.

The OCC should instead create regulatory fairness by regulating firms according to the risks they create. This means that the OCC should regulate fintech firms based on what is required to provide appropriate protection for customers and encourage access and innovation in light of the concerns presented by the fintech firms' unique business model.

In light of this, the OCC's proposal for SPNBs is overly burdensome. Despite the different risk profiles presented by fintechs, the OCC's proposal subjects them to many of the same requirements traditional depositories face, despite the fact that they are unnecessary to protect customers. These requirements include submitting a detailed business plan and obtaining a non-objection letter if the SPNB wishes to deviate from the business plan. SPNBs also may be required to develop alternative minimum business strategies that would detail their plans to react to a host of different business conditions. These requirements exist to assure the OCC that each SPNB will not fail, but firm survival is not necessary for customer or systemic protection.

As J. W. Verret and I previously described in greater detail in the context of the OCC's proposed rule on receiverships for uninsured national banks,[6] the OCC should focus on making certain that non-depository SPNBs have the ability to fail in a way that protects customers. This would require the SPNB to be able to wrap up operations in an orderly manner and transfer any ongoing obligations (such as loan servicing) to a backup provider with adequate time to provide customers with sufficient notice and information to allow the customers to protect their interests. If the SPNB were able to complete all of its outstanding tasks or ensure those tasks were properly transferred to a new entity that would complete them, then the customer, and

5. OCC, "About the OCC," accessed March 23, 2017.
6. See Brian R. Knight and J. W. Verret, "Comment on the Proposed Rule regarding Receiverships for Uninsured National Banks" (Public Interest Comment, Mercatus Center at George Mason University, Arlington, VA, November 14, 2016).

by extension the banking system, would be protected.[7] In fact, a well-executed failure could allow SPNBs to avoid receivership entirely and be resolved via bankruptcy because all of the customer (as opposed to investor or corporate creditor) interests will have been addressed.

While the current proposal does mention the importance of an orderly wind-down, it falls short in giving appropriate weight to the ability to fail with grace. The focus on requirements intended to demonstrate that SPNBs will not fail is not only unnecessary but may also be counterproductive.

For example, the requirement that an SPNB get a non-objection letter for any material deviation from its business plan could make it more difficult for the SPNB to survive adverse business conditions. Many firms, especially those that are seeking to provide the most innovative solutions, will find the need to change their business plans quickly to survive. If an SPNB is forced to request permission from the OCC, and if that permission is not provided quickly, the firm will be forced to choose between risking regulatory sanction or the death of the firm. To even have a chance of being adequately responsive to the needs of SPNBs, the OCC will have to devote considerable resources to processing non-objection letters. It is doubtful that the OCC will be able to make such a sustained commitment given the OCC's other obligations and limited resources. As such, the non-objection letter requirement is likely to make it more, not less, likely that SPNBs will fail.

Whatever the value of the OCC requiring depository institutions to convince the OCC they will not fail, non-depository SPNBs present a materially different issue. The OCC should not just adapt existing requirements where they are not warranted. Instead, the OCC should focus on the critical element of protecting customers in the fintech context: the ability of SPNBs to fail in an orderly manner that protects customers.

THE OCC SHOULD CLARIFY THE REQUIREMENTS SPNBS WILL HAVE TO MEET TO OBTAIN AND MAINTAIN A CHARTER CONSISTENT WITH THE RIGHTS AND RESPONSIBILITIES OF NATIONAL BANKS UNDER RELEVANT LAW

The OCC's current proposal remains vague about certain charter requirements. These requirements could, depending on how the OCC interprets and applies them, exceed what is required and infringe on the powers of SPNBs. The OCC should clarify its expectations to provide certainty to SPNB applicants and ensure that the OCC does not unduly restrict SPNBs.

For example, the current proposal requires SPNBs to develop a financial inclusion plan (FIP) that is acceptable to the OCC as a condition of obtaining a charter. The proposal is vague as to what an FIP would require, and it contemplates the requirements varying based on the SPNB's

---

7. These process safeguards address servicing risk but do not speak to any risks created by the underlying assets (e.g., default risk). However, default risk exists regardless of whether fintechs become SPNBs. Further, the current size of the fintech market is well below systemic significance. If this begins to change, the government will have time to adjust regulation as necessary.

business model and product offerings. The proposal also requires SPNBs to obtain ongoing public input on their FIPs. The OCC grounds the FIP requirement in the OCC's obligation to ensure that national banks provide "fair access to financial services and fair treatment of customers."[8] These requirements may actually be more onerous[9] than what is required by the Community Reinvestment Act (CRA).[10]

While the OCC may possess the authority to encourage SPNBs to pursue financial inclusion, it should avoid imposing requirements that mimic, or exceed, the requirements of the CRA, which does not apply to non-depository institutions.[11] For example, the requirement that each SPNB solicit, consider, and respond to public comment on its FIP, which the OCC will consider as part of its examination of the SPNB, is akin to the public comment the OCC solicits under the CRA.

When it drafted the CRA, Congress could have included non-depository institutions, but elected not to. Whatever the merits of expanding the CRA to cover non-depository institutions may be, it is a question Congress—not the OCC—should address. Imposing similar, or more onerous, requirements to SPNBs without clear statutory authorization risks frustrating Congress's legislative purpose. Additionally, the further the OCC gets from the clear requirements of the underlying statute, the more risk that the implementation will vary significantly depending on OCC leadership, denying SPNBs regulatory certainty.

Likewise, the OCC proposal states that companies offering "predatory" products and services would not be eligible for a charter. While unfair, deceptive, and other illegal behavior should be aggressively suppressed, failure to clearly and properly define what constitutes predatory behavior risks chilling innovation and the expansion of services to the groups that need them most.

For example, many SPNBs seek to provide services to traditionally underserved groups that may present a relatively high credit risk, which means a relatively high interest rate must be charged to compensate for the risk. SPNBs also seek to provide services using innovative techniques. Firms using new methods may set their prices assuming the new method is only moderately successful. In cases where the new method is more successful than anticipated, the firm may enjoy greater profits than initially anticipated, at least in the short term. However, those profits are likely to be driven down by competition.

Given that "targeting" underserved groups and costs that "exceed the true risk and cost of making a loan" have been previously identified by the OCC as points of concern for bank examiners,[12] the OCC should provide more explicit guidance on what it considers to be predatory behavior. In doing so, the OCC should consider that under the National Bank Act,

8. OCC, "Comptroller's Licensing Manual Draft Supplement," 20n50.
9. Lalita Clozel, "Financial Inclusion Rules Tougher than CRA in OCC Fintech Charter," *American Banker*, April 3, 2017.
10. Community Reinvestment Act of 1977, 12 U.S.C. § 2901.
11. Community Reinvestment Act of 1977, 12 U.S.C. § 2902(2).
12. OCC, "OCC Advisory Letter 2000–7: Abusive Lending Practices," July 25, 2000.

a national bank is entitled to operate pursuant to the laws governing interest in its home state.[13] As such, merely charging a relatively high interest rate should not be considered predatory or bar a firm from becoming an SPNB. Likewise, being profitable is not illegal. Preventing SPNBs from offering credit at relatively high rates may prevent SPNBs from serving the underserved.[14] Similarly, treating profitability in and of itself as a source of concern could discourage firms from entering risky markets.[15] Such an outcome would frustrate one of the most important potential benefits of the OCC's SPNB charter.

CONCLUSION

The OCC's efforts to provide a national bank charter that works for innovative non-depository fintech firms show promise. As currently proposed, however, the charter risks being unduly burdensome and unnecessarily vague. The OCC should amend its proposal to focus on providing SPNBs with clear regulation that provides for appropriate customer protection without imposing unnecessary or inappropriate burdens, restrictions, or requirements.

ATTACHMENT

Brian R. Knight, Hester Peirce, and J. W. Verret, "Response to OCC White Paper Exploring Special Purpose National Bank Charters for Fintech Companies" (Public Interest Comment, Mercatus Center at George Mason University, Arlington, VA, January 15, 2017).

13. 12 U.S.C. § 85; Department of the Treasury, Charging Interest by National Banks at Rates Permitted Competing Institutions; Charging Interest to Corporate Borrowers, 12 C.F.R. 7.4001; Smiley v. Citibank (South Dakota), N.A., 517 U.S. 735 (1996).
14. See Colleen Honigsberg, Robert J. Jackson Jr., and Richard Squire, "What Happens When Loans Become Legally Void? Evidence from a Natural Experiment" (Columbia Business School Research Paper No. 16-38, December 2, 106). The authors find a significant reduction in credit availability from online platforms for low credit score borrowers after the *Madden v. Midland Funding LLC* decision called into question whether loans above the New York usury limit remained valid after being sold by a bank to a nonbank.
15. Profits derived from unfair, deceptive, or other illegal activity are of course a different matter, but it is the underlying bad act, not the mere fact of profitability, that justifies a forceful regulatory response.

MERCATUS CENTER
George Mason University
Bridging the gap between academic ideas and real-world problems

PUBLIC INTEREST COMMENT

RESPONSE TO OCC WHITE PAPER EXPLORING SPECIAL PURPOSE NATIONAL BANK CHARTERS FOR FINTECH COMPANIES

BRIAN R. KNIGHT
Senior Research Fellow, Mercatus Center at George Mason University

HESTER PEIRCE
Senior Research Fellow and Director, Financial Markets Working Group, Mercatus Center at George Mason University

J. W. VERRET
Senior Affiliated Scholar, Mercatus Center at George Mason University
Associate Professor, Antonin Scalia Law School

White Paper Exploring Special Purpose National Bank Charters for Fintech Companies
Agency: Office of the Comptroller of the Currency, Department of the Treasury
White paper released: December 2, 2016
Comment period closes: January 15, 2017
Submitted: January 15, 2017

Thank you for the opportunity to comment on the Office of the Comptroller of the Currency's (OCC's) proposal for extending national bank charters to fintech companies.[1] The Mercatus Center at George Mason University is dedicated to bridging the gap between academic

1. The OCC refers to this as "a paper discussing the issues and conditions that the agency will consider in granting special purpose national bank charters," rather than a proposal. Office of the Comptroller of the Currency, OCC to Consider Fintech Application, Seeks Comment, December 2, 2016. Because the OCC is taking comments, we understand this document to be a proposal.

For more information, contact
Chad Reese, Assistant Director of Outreach for Financial Policy
703-993-8921, creese@mercatus.gmu.edu
Mercatus Center at George Mason University
3434 Washington Boulevard, 4th Floor, Arlington, VA 22201

ideas and real-world problems and to advancing knowledge about the effects of regulation on society. This comment, therefore, does not represent the views of any particular affected party or special interest group, but is designed to assist the OCC in establishing a regime that will benefit the public by facilitating increased innovation, competition, and access to financial services.

INTRODUCTION

The OCC is considering whether and how to grant special purpose national bank charters expected to be used primarily by non-depository fintech firms.[2] These "fintech banks" will enjoy all of the relevant powers granted to national banks under the National Bank Act[3] and will be subject to supervision by the OCC. In response to the OCC's proposal and request for comment,[4] this letter discusses how the OCC should structure its fintech bank charter program and how the current proposal should be modified to better accomplish its goals.

We commend the OCC for its willingness to consider what it can do to foster innovative means of providing financial services. The OCC sets a model for other agencies by asking whether the current regulatory structure is unduly impeding competition and inclusion and by looking for ways to remove any impediments it finds. As the OCC's proposal recognizes, a fintech charter has the potential to benefit consumers while also strengthening the national bank system, the affected companies, and the country's economic growth and dynamism.[5]

We agree that a special purpose national bank charter for fintech companies has promise, and thus we support the OCC's general proposal to offer a fintech charter. A properly constructed and administered fintech charter offers public policy benefits. The charter can provide a clear legal framework within which fintech firms can serve consumers under effective regulatory oversight without having to comply with multiple, conflicting state laws. Legal certainty will enable firms to focus their efforts on understanding and meeting consumer needs. A workable fintech charter will facilitate innovations that can improve the functioning of the financial markets and the lives of those that use them. A special purpose charter will not serve to foster innovation, however, unless the OCC properly designs and administers the charter.[6]

Accordingly, we make the following recommendations about how the OCC should proceed. In making these recommendations, we are mindful of the OCC's goals of fostering innovation,

2. While nothing in the OCC's release excludes depository institutions, they are already eligible for federal charters and would likely also require approval by the Federal Deposit Insurance Corporation. Accordingly, this letter will focus on the application of a charter to non-depository institutions. We are aware that some have argued that the OCC lacks the authority to extend charters to non-depository institutions. For the purposes of this letter we assume the OCC has the necessary authority.
3. 12 U.S.C. § 1 *et seq.*
4. Office of the Comptroller of the Currency, "Exploring Special Purpose National Bank Charters for Fintech Companies," December 2016 (hereinafter OCC Proposal).
5. Ibid., 2.
6. Cooperation from state regulators is also important, but may not be forthcoming. See, for example, New York State Department of Financial Services, "Statement by DFS Superintendent Maria T. Vullo Regarding the OCC Special Purpose National Bank Charters for Fintech Companies," December 2, 2016.

protecting consumers, and acting in compliance with principles of good government. Specifically, we recommend that the OCC:

- avoid imposing unnecessary constraints on fintech charter recipients;
- make the standards and expectations for firms seeking a fintech charter transparent and objective and limit the staff's ability to add and subtract requirements for particular firms;
- avoid using the chartering process to protect national banks from competition;
- recognize a role for competitive federalism; and
- work with other regulators to provide fintech firms consistent federal regulatory treatment.

We discuss each of these recommendations in turn.

THE OCC SHOULD AVOID IMPOSING UNNECESSARY REQUIREMENTS ON FINTECH BANKS

The fintech industry comprises firms offering a diverse array of services, including lending, payments to digital currency services, and investment advice. Many fintech companies—including the ones that are the subject of the OCC proposal—do not look or act like traditional deposit-taking banks, and regulating them in the same way as depositories is neither appropriate nor efficient. The proposal, however, envisions applying to fintech companies the same "safety and soundness" framework under which depositories are regulated.

A safety and soundness framework is unnecessary for a fintech company that does not hold customer deposits. To the contrary, such a framework—which focuses on keeping the regulated institution in business, often by curtailing the risks the institution takes—threatens to undermine the dynamism that fintech companies offer. A regulatory framework for fintech companies should not focus on the survival of any individual company, but on keeping barriers to entry low and ensuring that firms have workable and effective plans in place to protect their customers in event of failure.[7]

The proposal suggests that other aspects of the traditional bank regulatory framework will be applied to firms that avail themselves of the fintech charter. For example, the OCC's proposed regulatory approach includes capital requirements, which the OCC suggests may "[exceed] the requirements for other types of banks."[8] Capital regulation for depository banks protects depositors and the Federal Deposit Insurance Fund by ensuring that there is enough equity in place to absorb any losses and helps to moderate the harmful effects of banking crises. High capital requirements, therefore, are not necessary for fintech firms that are not backed by

7. For a discussion of the role the OCC can play in ensuring that fintech firms have adequate wind-down plans, see Brian Knight and J. W. Verret, "Comments on the Proposed Rule Regarding Receiverships for Uninsured National Banks" (Public Interest Comment, Mercatus Center at George Mason University, Arlington, VA, November 14, 2016).
8. OCC Proposal, 10.

government deposit insurance and do not hold customer funds. The OCC should set capital requirements with an eye to insuring that customers do not face extra-contractual risks, not that banks never fail. Moreover, fintech firms of the sort for which the charter is intended are so small that their failure is unlikely to raise concerns for the broader economy.[9]

The OCC also proposes to condition a charter on adherence to a financial inclusion framework similar to the Community Reinvestment Act (CRA),[10] which only applies to insured depository institutions.[11] Congress drafted the CRA to extend only to insured depository institutions. To the extent that the CRA should be expanded or modified, Congress should make the decision to do so. In making that determination, Congress would have to consider whether the very populations the CRA is intended to protect would be harmed by adding a layer of legal and operational complexity to financial services innovation.[12] Legal questions would arise, for example, because CRA enforcement historically has relied on regional-based metrics of community reinvestment, including the extent to which a bank has branches in low-income neighborhoods near wealthier neighborhoods in which it has branches. The OCC expects a fintech bank seeking a charter to "demonstrate its commitment to financial inclusion to individuals, businesses and communities."[13] As Internet-based financial services increase in importance, such an approach to financial inclusion becomes more difficult to apply. A mechanical application of financial inclusion mandates could discourage fintech models that serve to increase access to financial services for low-income and underbanked consumers. Instead, the OCC should take a bigger picture view and recognize that the very presence of new competitors in the financial industry promotes financial inclusion.

The OCC is considering using "its chartering authority as an opportunity to address the gaps in protections afforded individuals versus small business borrowers."[14] As with CRA obligations, any changes to the requirements placed on lenders should be made by Congress. The imposition of extra-statutory requirements on fintech banks risks frustrating Congress's purpose in establishing the scope of the relevant law. Unless the OCC were also to apply the enhanced requirements to traditional banks, it also risks creating a multitiered regulatory system where fintech and non-fintech banks conducting identical activities are held to different regulatory standards.[15] Moreover, fintech firms faced with consumer-style regulations might eschew further investments in innovative small business lending alternatives.

9. Fintech firms may at some point scale to the point where they may pose systemic risks; however, they are not close to that point, and regulators will have ample opportunity to address those concerns if they develop.
10. 12 U.S.C. § 2901 *et seq.*
11. OCC proposal, 12. See also Office of the Comptroller of the Currency, "Remarks by Thomas J. Curry, Comptroller of the Currency Regarding Special Purpose National Bank Charters for Fintech Companies," December 2, 2016, 6, https://www.occ.treas.gov/news-issuances/speeches/2016/pub-speech-2016-152.pdf (hereinafter "Comptroller Curry's Remarks"). "*On the other hand*, the OCC has the unique ability to *impose* requirements in some or all of these areas through the chartering process to require companies seeking national charters to support financial inclusion in meaningful ways, as appropriate for the business model and activity of a particular company" (emphasis in original).
12. The burden could be particularly onerous if the OCC requires fintech firms to meet financial inclusion standards globally, as the proposal suggests. OCC Proposal, 30.
13. Ibid., 15.
14. Ibid., 15.
15. Even if the OCC were to impose enhanced requirements on existing national banks, it would not be able to impose those same requirements on state-chartered banks.

Other elements of the proposed framework also may make it unworkable for most fintech firms. For example, the proposal seems to envision fintech firms getting approval before they begin operations. How would this model work for the many fintech firms already in operation? The proposal would require fintech firms to prove to the OCC that they have "a reasonable chance of success,"[16] provide detailed plans for products and services,[17] and "obtain approval, or no objection, from the OCC" for material departures from these plans.[18] Fintech firms are used to making adjustments in their products and services quickly in direct response to feedback from users. A regulatory framework that requires the OCC to weigh in on the likely commercial success of every tweak made in response to consumer demands would likely be unworkable.

CONSISTENT, TRANSPARENT STANDARDS SHOULD GOVERN THE FINTECH CHARTER

The OCC correctly acknowledges the diversity among fintech firms and the resulting need to accommodate these differences. While flexibility is important and some discretion is necessary, the OCC should, to the greatest extent possible, make the requirements and process for obtaining a charter transparent, predictable, and objective. The OCC should undertake adequate due diligence and should take into account the unique features of each firm to which it grants a charter. At the same time, it must avoid an arbitrary and unpredictable chartering process.

The proposal gives some cause to worry that a one-off process that imposes inconsistent burdens and safeguards will emerge. The OCC has stated appropriately that it plans to "articulate specific criteria for approval" of fintech banks.[19] However, the OCC also has discussed a non-transparent chartering process that entails substantial discretion in imposing requirements and assessments on fintech special purpose banks. For example, the proposal states that the "OCC may impose additional conditions for a variety of reasons" and suggests that the OCC might require fintech firms to enter into firm-specific operating agreements that contain substantive provisions.[20] The proposal seems to indicate that much of the discussion over those conditions will occur in nonpublic "formal and informal meetings" that precede a formal charter application.[21]

The OCC should announce specific criteria for presumptive charter eligibility. If a company meets the preannounced set of criteria, it will be presumed to be eligible for a charter. The OCC could overcome the presumption and refuse to grant a charter, but would have to provide its reasons to the firm, which then could address any failings. A clear set of consistently applied

---

16. OCC Proposal, 13.
17. Ibid., 9.
18. Ibid., 13.
19. Comptroller Curry's Remarks, 5
20. OCC Proposal, 14.
21. Ibid., 13. See also ibid., 8, which states that "applicants for a special purpose charter are strongly encouraged, prior to filing an application, to meet with the OCC to discuss these baseline expectations in detail and how the expectations (and any others arising from the particular proposal) apply to their proposed bank."

charter criteria would not leave firms in doubt as to their charter prospects. Announcing criteria that bind the OCC as much as they bind the firms seeking a charter is the best way to provide the necessary equity, transparency, and predictability.

THE OCC SHOULD NOT USE THE FINTECH CHARTER TO GIVE A COMPETITIVE ADVANTAGE TO EXISTING NATIONAL BANKS

The promise of fintech banks is that they bring competition, innovation, and dynamism to a market that has arguably become ossified. The OCC's overriding concern for the national banks that represent the bulk of its regulated entities may manifest itself in requirements that place fintech firms at a competitive disadvantage.

The proposal raises competitive concerns, but does so from the perspective of national banks. For example, the OCC asks whether fintech banks would "have any competitive advantages over full-service banks the OCC should address."[22] The proposal also worries about risks from unchartered fintech banks.[23] Concern about fintech firms being at a competitive *disadvantage* seems more relevant. The OCC's exercise, rather than offering a workable federal regulatory option for fintech firms, may become an indirect means to so stringently regulate competitors of national banks that these new entrants cannot pose a competitive threat to national banks. As discussed above, the OCC is contemplating applying a set of requirements to fintech firms that are inapt, and it may do so through a non-transparent process that makes competitive inequities more difficult to detect.

As one example, capital requirements can serve as a barrier to entry that protects incumbents from competition. The likelihood that capital requirements on fintech banks could serve an anticompetitive role is heightened by the proposal's expectation that fintech banks will be required to have relatively more capital than their depository peers.[24] As discussed in more detail in Brian Knight and J. W. Verret's comment on the OCC's proposed rule regarding receiverships for uninsured national banks, non-depository fintech firms present different risks and considerations than traditional banks.[25] The OCC should focus on making certain there is adequate capital for a firm to orderly wind down. Imposing excessive capital requirements relative to fintech banks' traditional peers would serve as an unnecessary barrier to entry, preventing competition and access that would benefit customers.

THE OCC'S FINTECH CHARTER SHOULD ACCOMMODATE COMPETITIVE FEDERALISM

The OCC should consider including elements in its fintech charter that permit competitive federalism to flourish among states in which fintech firms are headquartered. There is historic

22. Ibid., 16.
23. Ibid., 16.
24. Ibid., 10.
25. Brian Knight and J. W. Verret, "Comment on the Proposed Rule Regarding Receiverships for Uninsured National Banks" (Public Interest Comment, Mercatus Center at George Mason University, Arlington, VA, November 14, 2016). Comment ID: OCC-2016-0017-0006.

precedent for such an approach. The OCC has referenced the laws of a bank's state of incorporation. For example, nationally chartered banks are permitted to use the corporate laws of the state in which they are headquartered, and thereby to export the headquarter state's corporate law to its relationship with shareholders in other states.[26] National banks are also able to export the usury laws of their home state to other states in which they do business.[27] The location of the borrower does not matter. This type of federal choice of law rule facilitates a competitive federalism. States have competed with each other to provide an optimal set of laws for banks to use nationwide. When states mutually recognize each other's laws, as is the case in corporate chartering, a competitive equilibrium can be achieved in which each state will continue to respect mutual recognition.[28]

Critics of competitive regulation at the state level argue that it creates a "race to the bottom" in which states compete to offer the least regulated regime. In the wake of the last crisis, some observers worried that regulatory competition at the state level produced lax consumer protection rules and, ultimately, the financial crisis. A wealth of economic literature challenges that assumption.[29] Market forces work against a race to the bottom if certain conditions are met. States must derive meaningful fees from the provision of law, and there must be free entry and exit for firms and their contractual counterparties, which ensures that firms will choose state laws that signal value to their counterparties.[30]

The dual banking system never lived up to its promise of regulatory competition. Exportation of state banking law from the chartering state to other states was never achieved. Even if it had been, it is likely that access to the federal safety net would have distorted the interstate competition.[31]

The nascent field of fintech provides an opportunity to use a federalism-based strategy that never worked for traditional banking. The OCC can design its new charter without regard for the pre-Internet era political constraints that led states to take a provincial approach to bank regulation through the 19th and much of the 20th century.[32] Access to the federal safety net will not play a role, either, because non-depository fintech firms will not have access to federal deposit insurance or the discount window. To meet the OCC's process prerequisites for preemption,[33] the OCC could draw on the economic evidence favoring regulatory federalism.[34]

26. See 12 C.F.R. § 7.200(b).
27. 12 U.S.C. § 85.
28. See Larry E. Ribstein and Erin Ann O'Hara, "Corporations and the Market for Law," *University of Illinois Law Review* 2008, no. 2 (2008): 661, 666.
29. The literature is reviewed at Joseph R. Mason, Robert Kulick, and Hal J. Singer, "The Economic Impact of Eliminating Preemption of State Consumer Protection Laws," *University of Pennsylvania Journal of Business Law* 12, no. 3 (2010): 781.
30. See Larry E. Ribstein, "Dabit, Preemption, and Choice of Law," *Cato Supreme Court Review* (2006): 141, 167.
31. See generally Jonathan R. Macey and Henry N. Butler, "The Myth of Competition in the Dual Banking System," *Cornell Law Review* 73, no. 4 (1988): 677.
32. See generally Charles W. Calomiris and Stephen H. Haber, *Fragile by Design: The Political Origins of Banking Crises and Scarce Credit* (Princeton, NJ: Princeton University Press, 2014).
33. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (July 21, 2010), requires the OCC to support its preemption decisions with "substantial evidence." Dodd-Frank §1044 [adding 12 U.S.C. § 5136C(c)].
34. See generally Larry E. Ribstein and Bruce Kobayashi, "The Economics of Federalism" (University of Illinois Law and Economics Working Paper No. LE06-001, January 2006), 4.

Though a true competitive federalism approach, with mutual recognition among states, would require new legislation, the OCC could take important steps under its existing authority, similar to its approach to usury rules and corporate governance rules. A 2005 proposal by the Federal Deposit Insurance Corporation (FDIC) offers a useful model. The FDIC proposed to allow state banks insured by the FDIC the same preemptive benefits that national banks chartered by the OCC receive.[35] The proposal would have allowed state banks to be governed for banking law purposes solely by their home states.[36] Had the proposal been adopted, it may have substantially reinvigorated the dual banking system.

THE OCC SHOULD WORK WITH OTHER FEDERAL REGULATORS TO ENSURE THAT FINTECH COMPANIES FACE CONSISTENT, COORDINATED FEDERAL REGULATION

As the OCC acknowledges, it is not the only regulator with an interest in fintech firms.[37] With respect to some fintech firms, such as those involved in investment advice and securities offerings, the OCC is not necessarily the right frontline regulator.[38] The OCC broadly reads its authority to conclude that "bank permissible, technology-based innovations in financial services" constitute a "special purpose" for which a national bank charter may be granted.[39] Coordination with other regulators is therefore very important. Given its deep interest in innovation, the OCC can play a leading role in bringing regulators together to build a workable framework for fintech. The OCC could coordinate with, among others, the Federal Reserve, the Securities and Exchange Commission, the Bureau of Consumer Financial Protection (CFPB), and the Commodity Futures Trading Commission.

As one part of this cooperative effort, the OCC should enter into a memorandum of understanding (MOU) with the CFPB regarding that agency's "Project Catalyst," an initiative the CFPB launched in 2012 "to encourage consumer-friendly innovation in markets for consumer financial products and services."[40] Under an MOU, regulatory forbearance provided to OCC-fintech-chartered firms would receive mutual recognition by the CFPB. Likewise, the OCC would honor regulatory forbearance afforded under Project Catalyst.

CONCLUSION

The OCC deserves praise for embracing innovation and being willing to adapt to a changing market. A fintech bank charter has significant potential to improve the public's access to

35. Interstate Banking; Federal Interest Rate Authority, 70 Fed. Reg. 60019 (proposed October 14, 2005).
36. For a discussion of the FDIC's proposal, see Elizabeth R. Schlitz, "Damming Watters: Channeling the Power of Federal Preemption of State Consumer Banking Laws," *Florida State University Law Review* 35, no. 4 (2008): 893, 940.
37. OCC Proposal, 6–8.
38. Many of these firms fit better within the Securities and Exchange Commission's domain. See, e.g., Michael S. Piwowar, "Statement at Financial Technology Forum," Securities and Exchange Commission, November 14, 2016. "Many of the firms pursuing FinTech are already SEC registrants, and others are providing services that are squarely within the Commission's oversight, such as investment advice and trading and settlement functionalities. And we are the only agency with a mission that explicitly includes facilitating capital formation."
39. OCC Proposal, 3–4.
40. Bureau of Consumer Financial Protection, Project Catalyst, accessed January 3, 2017.

quality financial services. There is also a risk, however, that well-meaning but inappropriate requirements will frustrate the charter's purpose by creating excessive and arbitrary barriers to entry. As the OCC proceeds toward issuing charters, it should be careful to structure its requirements to avoid this anticompetitive and anti-innovation outcome. The OCC's laudable mission is best served by creating a charter that is both accessible and equitable.