

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

September 24, 2020

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: September 29, 2020, “License to Bank: Examining the Legal Framework Governing Who Can Lend and Process Payments in the Fintech Age”

The Task Force on Financial Technology will convene for a virtual hearing entitled, “License to Bank: Examining the Legal Framework Governing Who Can Lend and Process Payments in the Fintech Age,” on Tuesday, September 29, 2020 at 12:00 p.m. EST, on the virtual meeting platform Cisco Webex. This single-panel hearing will have the following witnesses:

- **Raúl Carrillo**, Policy Counsel, Demand Progress Education Fund; Fellow, Americans for Financial Reform Education Fund
- **Everett K. Sands**, Chief Executive Officer, Lendistry
- **Arthur E. Wilmarth, Jr.**, Professor Emeritus of Law, George Washington University Law School
- **Brian Knight**, Director, Innovation and Governance Program, Mercatus Center

Overview

The novel coronavirus 2019 (“COVID-19”) pandemic has had a significant public health and economic impact in the United States. In a time of crisis, everyday American’s ability to receive government loans and benefits, bank in-person, and use of physical currency has shifted dramatically. As consumer’s adjust to the changes, it is unclear whether most consumers understand the difference in protections and oversight between “banks” and “technology companies” when participating in financial activities, like sending money to a friend. Technology companies are increasingly offering services lines that are financial in nature. While the process for obtaining a bank charter can take over a year; requiring applicants to provide regulatory authorities with information about their business plans, senior management teams, capital adequacy, and risk-management infrastructure, among other things¹, technology companies do not have a similar comprehensive federal form of regulation regarding their financial-related products and services.² This hearing will examine the legal framework and regulatory scope governing the oversight of traditional banks and other commercial businesses – especially technology companies – engaged in financial activity and the effect on consumer protection, financial stability, and the traditional separation of banking and commerce.

Bank Charters available to Fintech and Commercial Companies

Fintech companies interested in the business of banking may choose to apply for a traditional charter, such as a national bank charter, and depending on the size, subject themselves to *all* the same requirements,

¹ See *How Can I Start a Bank?* Bd. of Gov. of the Fed. Res. Sys. (last updated Aug. 2, 2013), http://www.federalreserve.gov/faqs/banking_12779.htm.

² See Goodwin Procter LLP, *Bank Partnership or Go It Alone?*, Aug. 23, 2016; and Goodwin Procter LLP, *So, You Want to be a Bank? Benefits of Operating through a Bank Charter and Charter Choice Considerations*, Oct. 11, 2018.

limitations, and supervision as a national bank. As described below, they may also consider applying for a special purpose charter that the Office of the Comptroller of the Currency (OCC) has proposed, or seek approval from the Federal Deposit Insurance Corporation (FDIC) to receive deposit insurance for state-regulated industrial loan companies (ILCs).

OCC's Special Purpose National Bank Charters for Fintech Companies. This charter would allow fintech firms to engage in activities within the business of banking (trustee, executor, or an administrator of assets) or core banking functions (receiving deposits, paying checks, or lending money). In the white paper, the OCC expressed interest in using authority under the National Bank Act of 1865 (NBA) and the Home Owners' Loan Act (HOLA) to grant Special Purpose National Bank (SPNB) charters to certain fintech firms and describing why such charters “may be in the public interest.”³ Since the OCC issued a white paper seeking public comment on a SPNB Charter for non-depository fintech firms in 2016, the proposal has been challenged by state regulators. In September 2018, the New York Department of Financial Services (NYDFS) filed a lawsuit in the U.S. District Court for the Southern District of New York challenging the OCC's decision to begin accepting relevant applications. There, NYDFS argued the OCC lacked the statutory authority to charter non-depository institutions because such institutions are not engaged in the “business of banking,” and the agency's decision violated the Constitution's Tenth Amendment by infringing state sovereignty.⁴ In May 2019, the district court sided with the NYDFS, relying on a historic definition of the term “bank” (which includes only depository institutions) and agreeing that the NBA does not authorize the OCC to charter non-depository fintech firms, the court concluded the phrase “business of banking” unambiguously excludes non-depository institutions.⁵ The OCC has appealed the district court's decision.⁶

OCC's Payment Charter. On May 29, 2020, Acting Comptroller of the Currency, Brian Brooks prioritized “enhancing the scope and relevance of the national charter.”⁷ Then, in June 2020, the Acting Comptroller announced planned phases to create a payment national banking charter by fall 2020.⁸ The proposal would create a national money transmitter license that preempts state licenses and provides nonbanks direct access to the Federal Reserve's payment clearing system.⁹ Supporters of the OCC's proposal argue that chartering eligible fintech firms would promote financial innovation and eliminate the need for the relevant companies to obtain licenses in each state in which they operate.¹⁰ Conversely, several bank industry associations voiced concerns over the potential payments charter and are prepared to “oppose any effort by the OCC to offer a narrowly focused payments charter” because in their interpretation, a

³ OCC, “[Exploring Special Purpose National Bank Charters for Fintech Companies](#),” (Dec. 2016).

⁴ *Vullo v. OCC*, 378 F. Supp. 3d 271, 280 (S.D.N.Y. 2019). The NYDFS and the Conference of State Bank Supervisors (CSBS) had previously filed lawsuits challenging the OCC's issuance of the draft supplement to the Comptroller's Licensing Manual. However, both lawsuits were dismissed on jurisdictional grounds. *See* Conference of State Bank Supervisors v. OCC, 313 F. Supp. 3d 285 (D.D.C. 2018); *Vullo v. OCC*, No. 17-cv-3574, 2017 WL 6512245 (S.D.N.Y. Dec. 12, 2017). Like the NYDFS, the CSBS also challenged the OCC's final supplement. However, the CSBS's second lawsuit was again dismissed on jurisdictional grounds. *See* Conference of State Bank Supervisors v. OCC, No. 18-cv-2449, 2019 WL 4194541 (D.D.C. Sept. 3, 2019).

⁵ *Id.* at 292-98. While the district court sided with the NYDFS on its statutory claim, it rejected the argument that the OCC's decision violated the Tenth Amendment. *See id.* at 298-300.

⁶ Notice of Appeal, *Lacewell v. OCC*, No. 1:18-cv-08377 (S.D.N.Y. Dec. 19, 2019).

⁷ OCC, “[Brian P. Brooks Statement on Becoming Acting Comptroller](#),” press release, May 29, 2020.

⁸ The mobile payments industry is estimated to generate over \$500 billion annually by 2020, reflecting an 80 percent compound annual growth rate over the previous five years. *See* [Mobile Wallets Are on Fire](#), BUS. INSIDER (Mar. 8, 2017). However, commentators have also raised certain concerns about rapid advances in mobile payments, including worries about cybersecurity, privacy, and provider insolvency. *See* Adam J. Levitin, [Pandora's Digital Box: The Promise and Perils of Digital Wallets](#), 166 U. PA. L. REV. 305, 335 (2018).

⁹ Acting Comptroller Brooks unveiled the plan in a podcast with the American Bankers Association (ABA). *See* ABA, “[Podcast: OCC's Brooks Plans to Unveil 'Payments Charter 1.0' This Fall](#),” June 25, 2020.

¹⁰ OCC, [OCC Summary of Comments and Explanatory Statement: Special Purpose National Bank Charters for Financial Technology Companies](#), (Mar. 2017)

fintech firm with a payment charter that doesn't take deposits, make loans, or have FDIC insurance would not be considered a bank under the BHCA and, therefore would not be subject to supervision by the Fed.¹¹ Moreover, other stakeholders previously expressed concerns with the OCC's efforts that: fintech firms would obtain SPNB charters to avoid state consumer-protection laws; the OCC's supervision of fintech SPNBs would be less rigorous than its supervision of full-service national banks; and, the existing scrutiny that fintech companies receive from state regulators, and the OCC's decision threatens to erode the distinction between banking and commerce—a separation typically justified by desires to minimize risks to the banking system, prevent anticompetitive behavior, and avert the concentration of economic power.¹²

Industrial Loan Companies seeking Deposit Insurance. Industrial loan companies (ILCs) are state-regulated, federally-insured banks that provide a range of typical banking services, such as making loans. ILCs, unlike most other banks, are not subject to the Bank Holding Company Act (BHCA), provided they do not accept demand deposits,¹³ have less than \$100 million in assets, or have experienced no change in control since 1987. There are 25 depository ILCs, two of which were recently approved by the FDIC in March 2020.¹⁴ This was the first time the FDIC approved ILC applications for deposit insurance in a number of years, going back to 2006 and 2007, and again from 2010 to 2013, when the FDIC and Congress imposed several moratoria preventing the ILC applications.¹⁵ These ILCs are chartered in five states, which allow ILCs to accept certain types of deposits, if the ILC has deposit insurance from the FDIC. As a result, their state charters allow ILCs to operate nationwide as FDIC-insured institutions.¹⁶ Certain characteristics of ILCs—particularly those owned by holding companies engaged primarily in non-financial commercial activity—have made ILCs controversial in recent decades.¹⁷

Opponents of ILCs assert that commercial firms' ownership of ILCs exposes the U.S. banking system and economy to various risks.¹⁸ For several reasons, historically, the United States has adopted policies that separate banking and commerce (i.e., buying and selling goods and services). For example, a mixed organization's bank subsidiary could have incentives to make decisions based on the interests of the larger organization, rather than on safe and sound banking principles.¹⁹ Meanwhile, the funding for this imprudent lending would be backed by federal deposit insurance (ultimately, the taxpayers). For this reason, proponents of the separation of banking and commerce argue that it prevents an inappropriate extension of the bank safety net to commercial enterprises.²⁰

Though the differences between banks and ILCs have narrowed, important legal and regulatory differences remain at the holding company level. Under criteria established in the BHCA, companies that own ILCs do not qualify as bank holding companies (BHC). This allows non-financial parent companies

¹¹ Letter from American Bankers Association et al. to Brian Brooks, Acting Comptroller of the Currency, Jul. 29, 2020, at <https://www.consumerfinancemonitor.com/wp-content/uploads/sites/14/2020/08/Payments-charter.pdf>.

¹² OCC Summary of Comments, *supra* note 13, at 4.

¹³ This demand deposit limitation is not a significant barrier, as ILCs may offer negotiable order of withdrawal (NOW) accounts that are functionally the equivalent.

¹⁴ See FDIC [Staff Memo](#) and [Notice of Proposed Rulemaking regarding Parent Companies of Industrial Banks and Industrial Loan Companies](#) (Mar. 2020). Also see [FDIC Approves the Deposit Insurance Application for Square Financial Services, Inc., Salt Lake City, Utah](#); and [FDIC Approves the Deposit Insurance Application for Nelnet Bank, Salt Lake City, Utah Area](#).

¹⁵ Press Release, "[Waters Calls on FDIC to Hold Public Hearing on SoFi's Application for Bank Charter](#)," (Aug. 25, 2017).

¹⁶ James Barth and Yanfei Sun, [A New Look at the Performance of Industrial Loan Companies and Their Contribution to the US Banking System](#) at 19 (Requested study, The University of Utah, Utah Center for Financial Services, January 2018).

¹⁷ Camden R. Fine, "In ILC Fight, [Community Banks Will Not Stand Down](#)," *American Banker*, August 17, 2017.

¹⁸ ICBA, [Industrial Loan Companies: Closing the Loophole to Avert Consumer and Systemic Harm](#), March 2019 at 5-10

¹⁹ Kenneth Spong and Eric Robbins, "[Industrial Loan Companies: A Growing Industry Sparks Public Policy Debate](#)," *Federal Reserve Bank of Kansas City Economic Review*, Fourth Quarter 2007 at 59-61.

²⁰ *Id.* at 62-64.

to own ILCs, creating an avenue for commercial firms such as retailers, manufacturers, and possibly technology companies to own FDIC-insured institutions. The ownership of ILCs by a wide range of commercial businesses raises questions over whether ILCs create an unacceptable mixing of banking and commerce.²¹ In addition, they are not subject to consolidated supervision by the Federal Reserve.²² This exemption from the BHCA raises questions over whether ILC parent companies are appropriately regulated, and whether they have unfair advantages over BHCs.²³ In 2007, the House of Representatives passed H.R. 698, the Industrial Bank Holding Company Act of 2007,²⁴ which would have enhanced the regulation of the parent companies of industrial banks, prohibited the FDIC from granting new charters to commercial companies seeking to start or acquire ILCs, and enhanced the examination and enforcement authorities of the FDIC as an ILC regulator. On the other hand, proponents of ILCs assert that these concerns are overstated and do not outweigh the benefits offered by ILCs,²⁵ some of which include: economies of scale (organizations can reduce costs with an in-house bank); risk diversification (mixed organizations are not entirely exposed to bank or commercial risks); customer convenience (financing and purchasing becomes “one-stop shopping”).²⁶

Banks Partnering with Fintechs. Banks are increasingly partnering with fintech entities to help facilitate with lending.²⁷ Estimates suggest marketplace lenders originated roughly \$41 billion in loans in 2017, reflecting more than a 30 percent increase over the previous year and a nearly 96 percent compound annual growth rate over the preceding five years.²⁸ Other analysts have projected that the industry will originate \$90 billion annually by 2020—still a small proportion of the overall lending market for consumer and small-business loans, but a volume that would continue to demonstrate significant expansion.²⁹ Earlier this year, the committee held a hearing discussing the potential harms to consumers when these partnerships are used to evade state laws related to usury caps.³⁰ When a loan is originated under such a partnership, the bank originates the loan but using the guidelines of the non-bank lender. This loan is then quickly sold to the non-bank lender. The consumer receives the loan from the bank. Under current federal law, national banks and Federal Deposit Insurance Corporation (FDIC)-insured state banks may maintain the maximum interest rates of the states where they are headquartered, meaning they can charge those rates even when lending to borrowers in other states with stricter usury laws.³¹ Legal questions have been discussed over

²¹ Independent Community Bankers of America, *supra* note 39, at 10-12.

²² An exception would occur when an ILC or its parent is designated a *systemically important financial institution*, over which the Federal Reserve has supervisory authority. See CRS, [Systemically Important or “Too Big to Fail” Financial Institutions](#).

²³ Independent Community Bankers of America, *supra* note 39, at 10-12. GAO and the Fed previously studied ILCs and recommended that Congress consider improving supervision and oversight of ILCs to allow for broader supervision akin to the supervision of bank holding companies. See GAO, [“ILCs: Recent Asset Growth and Commercial Interest Highlight Differences in Regulatory Authority,”](#) (Sep. 15, 2005); GAO, [“BHC Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions”](#) (Jan. 19, 2012); and Board of Governors of the Federal Reserve System, FDIC and the Office of the Comptroller of the Currency, [“Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act”](#) (Sep. 2016).

²⁴ <https://www.congress.gov/bill/110th-congress/house-bill/698>. The bipartisan bill was approved by the House by a 371-16 vote, though the Senate did not act on the measure.

²⁵ James Barth et al., [Industrial Loan Companies: Supporting America’s Financial System](#), The Milken Institute, April 2011, at 69..
²⁶ *Id.* at 62-65.

²⁷ See for example, U.S. Department of the Treasury, [“Opportunities and Challenges in Online Marketplace Lending,”](#) May 10, 2016; and U.S. Department of the Treasury, [“A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation,”](#) Jul. 31, 2018.

²⁸ [2018 US Digital Lending Market Report](#), S&P GLOBAL 6 (2018).

²⁹ Treasury Marketplace Lending Report, *supra* note 18, at 9.

³⁰ Committee on House Financial Services hearing, [“Rent-A-Bank Schemes and New Debt Traps: Assessing Efforts to Evade State Consumer Protections and Interest Rate Caps”](#) (February 2020).

³¹ *Marquette Nat’l Bank of Minneapolis v. First Omaha Servs. Corp.*, 439 U.S. 299, 303 (1978); 12 U.S.C. §§ 85, 1831d(a). See generally, Congressional Research Service (CRS) Report, [“Federal Preemption in the Dual Banking System: An Overview and Issues for the 116th Congress,”](#) May 17, 2019.

the years as to whether such an exemption for a federally chartered or insured bank also applies to non-banks that purchase loans from banks in these and other types of partnerships.³²

In 2015, the Second Circuit decided in *Madden v. Midland Funding, LLC*, that a non-bank debt collector could *not* benefit from the exportation power of a national bank from which it had purchased credit-card debt.³³ In *Madden*, a New York borrower sued a debt collector for violating New York usury law because the interest rate on her debt exceeded New York’s limit of 25 percent per year. The Second Circuit sided with the borrower, reasoning that New York usury law would not “significantly interfere” with the national bank’s powers because the debt collector was a separate entity and was not acting on the bank’s behalf.³⁴

Later last year, the OCC and FDIC proposed rules to override the *Madden* decision and adopt the “valid when made” principle for bank-originated loans.³⁵ The OCC’s proposed rule would amend its regulations governing national banks to provide that “[i]nterest on a loan that is permissible under [Section 85 of the NBA] shall not be affected by the sale, assignment, or other transfer of the loan.”³⁶ Additionally, in July of this year, the OCC released another rule proposal on this topic that would apply the true lender doctrine to banks in non-bank partnerships if at origination, the bank is listed in the loan agreement and if the bank is the entity funding the loan.³⁷ Consumer law advocates, State Attorneys General, and other experts have expressed deep concerns about the proposed rules and corresponding guidance.³⁸ They have highlighted that allowing rent-a-bank partnerships could lead to a return of triple-digit interest loan products in the states and territories that passed laws prohibiting them.³⁹

³² The National Consumer Law Center for instance points to the “true lender” doctrine that states that if the non-banks have the primary economic interest, then the non-bank is the true lender and they must comply with the state interest rate laws. National Consumer Law Center, [FDIC/OCC Proposal would Encourage Rent-a-Bank Predatory Lending](#) (Dec. 2019).

³³ 786 F.3d 246, 249-53 (2d Cir. 2015).

³⁴ *Id.*

³⁵ See Office of the Comptroller of the Currency (OCC) Proposed Rule, [Permissible Interest on Loans That Are Sold, Assigned, or Otherwise Transferred](#), 84 Fed. Reg. 64,229, 64,231 (November 2019).; [FDIC Proposed Rule, Federal Interest Rate Authority](#), 84 Fed. Reg. 66,845, 66,848 (December 2019).

³⁶ *Id.* The OCC’s proposed rule also includes a similar provision that would amend its regulations governing federal savings associations, which possess the same exportation power as national banks, 12 U.S.C. § 1463(g). In its Notice of Proposed Rulemaking (NPRM), the OCC explained that it was issuing the proposal in response to regulatory uncertainty created by the *Madden* decision, and that “various provisions of Federal banking law” support its interpretation of the exportation power. *Id.*

³⁷ OCC, “[2020 Proposed Rule, National Banks and Federal Savings Associations as Lenders](#),” 85 Fed. Reg. 44223.

³⁸ In 2017, State Attorneys General from 20 states wrote to Congress opposing provisions essentially overturning *Madden* in the Financial CHOICE Act (H.R. 10). The letter noted that the bill “would restrict states’ abilities to enforce interest rate caps. It is essential to preserve the ability of individual states to enforce their existing usury caps and oppose any measures to enact a federal law that would preempt state usury caps.” See State of New York Office of the Attorney General letter to Congress opposing the Financial CHOICE Act (June 2017), available at https://ag.ny.gov/sites/default/files/6.7.2017_choice_act_letter.pdf. In 2020, 24 bipartisan Attorneys Generals submitted a comment to the FDIC with similar concerns, opposing their rent-a-bank proposed rule, at <https://ag.ny.gov/press-release/2020/attorney-general-condemns-proposal-allowing-predatory-lenders-exploit-nations>.

³⁹ Center for Responsible Lending, Americans for Financial Reform, and National Consumer Law Center, [FDIC/OCC Proposal Would Encourage Rent-a-Bank High-Cost Predatory Lending](#) (2019), at <https://www.responsiblelending.org/media/fdic-occ-proposal-would-encourage-rent-bank-high-cost-predatory-lending>. More recently, stakeholders have warned that states with newly established state rate caps like California and Colorado risk seeing a federally legal return of these products through rent-a-bank partnerships. See National Consumer Law Center, Issue Brief: Payday Lenders Plan to Evade California’s New Interest Rate Cap Law Through Rent-A-Bank Schemes (2019), at <https://www.nclc.org/issues/ib-rent-a-bank.html>. The Colorado Attorney General recently settled a lawsuit against two fintech non-bank lenders for engaging in rent-a-bank schemes to violate the state’s 36% rate cap. The settlement includes a mandate that these lenders can only lend at interest rates that do not exceed 36% per Colorado state law, <https://coag.gov/press-releases/8-18-20/>.