Exploring Special Purpose National Bank Charters for Fintech Companies

Request for comment provided by TransferWise

Introduction from TransferWise

In December 2016, the Office of the Comptroller of the Currency (OCC) published preliminary thoughts on expanding national bank charters to financial technology (fintech) companies and their growing position of nonbank providers for financial services across the nation. In their open letter to the fintech industry, the OCC presented an invitation for engagement on the topic.

It is our hope that feedback on *Exploring Special Purpose National Bank Chargers for Fintech Companies* will help inform and guide the OCC in their process.

TransferWise is a fintech company focusing on international money transmission. Launched in January 2010 by Kristo Käärmann and Taavet Hinrikus. From the onset, TransferWise set out to address the challenges of international money transmission. Notably, the company wanted to address manipulated exchange rates, overcharging, and a poor customer experience.

First, identifying that consumers were often beset by an inconspicuous manipulation of the exchange rate— often billed as “hidden fees”—, TransferWise built a product atop the fair mid-market rate without any spread. Second, modern technology and clever liquidity management helped the company keep costs low. Independent third party studies often find that TransferWise is up to eight times cheaper than a bank. Third, the company positioned its online product and mobile applications to always be available to consumers, alongside twenty-four-hour support.

Over the last seven years TransferWise has grown to handing over $1B in volume per month for some 1MM customers around the world. With over 600 employees across six offices TransferWise is a great example of a fast-growing and progressive fintech company— the exact type that OCC has in mind with this call for feedback.

Request for comment

In their paper the OCC posed the below questions for public comment.

1. What are the public policy benefits of approving fintech companies to operate under a national bank charter? What are the risks?

As the OCC points out in their introduction there are several policy benefits towards approving fintech companies to operate under a national bank charter.

One of the foremost benefits will be a consistent and uniform nature in regulation and expectation. The current landscape for fintech is varied. With a division between state and federal oversight, the industry sits atop a complex and patchwork system of regulatory responsibility. Ultimately, this granular segmentation opens the financial systems of fintech to large inefficiencies and potential weakness.

Looking at money services businesses (MSBs) as an example, there is much to gain from the OCC's approval of a national bank charter for them. State-level licensing programs regulations largely impact MSBs. For fintech companies operating in this space, the state-by-state licensing programs and their varied requirements creates a barrier to access the national market. This overhead often impedes MSBs from expanding and creating fair competition in their industry sector.

The variance in state license programs also can pose a risk to consumers. An MSB that serves multiple jurisdictions may be required to offer different experiences, receipts, and products. With the freedom of movement in the United States, consumers may then receive differing experiences should they relocate from one state to another. And without a national footprint, some consumers may lose access entirely to a fintech company's product and services.

By creating a national bank charter for fintech, the OCC can bring a level plane for the construction of a competitive market. Standards in areas including governance, capitalization requirements, regulator and regulatory relationships, Bank Secrecy Act and Anti-Money Laundering practices, and more would enable clear and consistent service for fintech companies across the nation.

Reducing the granular local-level licensing and regulatory overhead would clear the way for greater innovation by taking advantage of national scale. As well, it would ensure the fair and consistent treatment of all consumers across the nation.

There may be some risks, though, in a national bank charter for fintech industries. One area is the breadth of fintech as an industry. While national banks and federal savings associations generally offer the same products and services, fintech is not a homogenous space. Nor is it a continuous and slow-paced space.

Fintech companies can range from MSBs, to investment products, to saving products, to loan and mortgage providers, and more. In the face of this scope, most fintech companies will seek to build and maintain a core product. However, a tenant of the industry to not only keep up with consumers but to help move consumers towards new financial services and ideas. It is common for a fintech company to evolve or expand in breath to offer additional products.

For example, an MSB might seek to move into a prepaid or stored value space to further offer transmission benefits to its customers. Or a savings product may turn to card issuing to provide access to the savings account at point-of-sale terminals. Both examples are illustrations of the widely scoped and fast-moving industry, where product pivots and growth are to be expected.

The OCC provides that fintech companies under a national charter may be exempt from certain regulation: “The OCC acknowledges, however, that to approve a fintech charter the agency may need to account for differences in business models and the applicability of certain laws. For example, a fintech company with a special purpose national charter that does not take deposits, and therefore is not insured by the Federal Deposit Insurance Corporation (FDIC), would not be subject to laws that apply only to insured depository institutions.”

As such, there will likely be complexity and overhead within the OCC to maintain a national charter structure with such a prevalence of exemptions and changes. Would a special charter discourage fintech companies from growing and innovating, given the possibility of the charter not supporting their activity? Might that national charter diminish the benefits of injecting fresh technology into the existing financial system?

2. What elements should the OCC consider in establishing the capital and liquidity requirements for an uninsured special purpose national bank that limits the type of assets it holds?

The OCC should consider a weighted or risk-based approach in establishing the capital and liquidity requirements for uninsured special purpose national banks that limit the type of assets they hold. Already the OCC provides for this consideration including the risks set out by the proposed products and services of the bank, the soundness of its management, and earnings.

Fintech business models may post some potential challenges to the OCC’s past model for establishing capital and liquidity requirements. Unlike national banks in the past, for example, some fintech companies may not have platform that supports or promotes local deposits and therefore lack an entire category of asset.

Therefore, there is an increased importance places on the accuracy of the funding sources, business forecast, cash flow forecasts, and the balance sheet. The OCC may also need to explore new ideas or definitions on permissible investments, to support the concept of assets for capital and liquidity decisions.

In general, a progressive and internationalized stance should be the best approach. In other words, the OCC should seek to continue an aligning the definitions and logic behind cross-market initiatives, such as the Basel Committee on Banking Supervision.

3. What information should a special purpose national bank provide to the OCC to demonstrate its commitment to financial inclusion to individuals, businesses and communities? For instance, what new or alternative means (e.g., products, services) might a special purpose national bank establish in furtherance of its support for financial inclusion? How could an uninsured special purpose bank that uses innovative methods to develop or deliver financial products or services in a virtual or physical community demonstrate its commitment to financial inclusion?

As the FDIC outlines in its May 2016 research findings report "Opportunities for Mobile Financial Services to Engage Underserved Consumers", core financial services needs of underserved consumers include: control over finances, access to money, convenience, affordability, security, customer service, and long-term financial management. The business models of many new and successful online and mobile financial services providers (such as the funds transfer services offered by TransferWise) are designed to meet these core needs in ways that most traditional banks are not.

The TransferWise business model currently specializes in providing cross-border money transfer to banked customers. Thorough research on its customer base has revealed key levers that drive consumer demand for money transfer--speed, cost, and convenience—and development driven by these key levers have resulted in a customer experience that naturally tends toward efficiently meeting the core needs highlighted by the FDIC.

Control over finances. TransferWise has built a platform for money transfer that informs customers up-front on the precise terms of transfers in a way that is easy to understand. Customers are informed in real time via the online dashboard on when funds are received, moved, and delivered. Transfer history is recorded onto the dashboard with all the terms of previous transactions, including downloadable receipts. This automated real-time transparency is a key feature of current services, and can easily be extended for any new product or service offerings.

Access to money. The TransferWise compliance software stores information about its customers through registration, onboarding and enhanced diligence, and lifetime account behavior patterns. This information enables us to make well-informed decisions distinguishing good customers from those with mal intent. Competent transaction monitoring software and well-resourced compliance development means that TransferWise maintains healthy control over the activity facilitated by the platform. This also enables TransferWise to make better decisions about the risks posed by certain categories of customers—and, more specifically--to speed transfers for good customers who pose lower credit and compliance risks. TransferWise could leverage this competence in tailored and informed risk decisions in expanding products and services to underserved communities.

Convenience. The TransferWise product teams build with convenience in mind. Practically speaking, this means that TransferWise reflects on learnings from customer contacts, conducts proactive customer research through interviews and phone calls, makes inferences about convenience based on data for when customers experience difficulty or drop off during the transfer flow. These learnings inform new product ideas to optimize customer experience, and new features are A/B tested to ensure that only improvements are implemented. This diligent customer research and attentiveness, along with strong development resources, means that the service becomes easier to use, easier to understand, and more convenient. Again, this competency can be leveraged to build products and services specifically tailored to needs of underserved communities.

Affordability. In offering cross-border money transfer, TransferWise always provides the current mid-market rate (the exchange rate utilized by banks and large liquidity providers when they trade with each other) and highly competitive fee structure which is provided up-front and in clear terms, prior to payment. This culture of transparency and the drive to reduce cost for consumers makes TransferWise an ideal service provider of affordable financial services for underserved communities.

Customer Service. TransferWise has established offices strategically around the globe to provide around-the-clock live customer service via multiple channels—phone, chat, email, social media. Customer support staff are well-informed about the product and service offering, communicate quickly and efficiently with operations and management staff and are thereby empowered to advocate for customers and develop comprehensive solutions in consultation with relevant teams. Often, well-informed customer support is sufficient to reassure customers who need additional clarifications, reassurance, or assistance with the platform. Feedback loops from customer service to development teams (as highlighted above) means that data on short term problem solving leads to comprehensive long-term solutions for common problems. A culture focused on customer needs means that TransferWise can remain engaged and responsive in the rollout of services for underserved consumers and feedback loops will support the iteration of high quality products tailored to their specific needs.

In short, the culture of new financial service models such as TransferWise are highly data-driven, responsive to learnings, valuing transparency and customer care and featuring powerful development capability. These features of new business models have demonstrated high success in designing technology to meet core consumer needs.

TransferWise currently only serves banked consumers, which is a key factor in maintaining its low risk profile within the MSB industry, particularly with banks holding the TransferWise Inc. accounts. The low risk profile has also been a key factor in fast but stable growth in the US market, but also limits its ability to promote financial inclusion. A special charter enabling TransferWise to expand product offerings under the direct oversight of the OCC would empower TransferWise to leverage its alignment of values with consumer protection and experience in meeting financial inclusion imperatives.

Special purpose banks would enable MSBs currently offering high-demand services for underserved consumers to expand product offerings for good customers otherwise currently perceived as risky. Institutions can articulate how they are already positioned to meet core needs of the underserved, and proposals for how they plan to expand services to accommodate. Proposed expansion of products and services could entail business plans that demonstrate understanding of the core needs of underserved populations, and detailed risk assessments that propose controls tailored to risks posed by the targeted population. Institutions can demonstrate quality of data collection and analysis, competency in product iteration, development resource. along with data providing evidence of a track record in transparency, responsiveness, safety.

4. Should the OCC seek a financial inclusion commitment from an uninsured special purpose national bank that would not engage in lending, and if so, how could such a bank demonstrate a commitment to financial inclusion?

As a first step, underserved populations have a need to access transaction accounts that provide access to affordable basic financial services, such as transfers, payments, savings, credit, and insurance. These needs are well-documented, as well as primary drivers for features that would best accommodate key needs.

Not all fintech service and product offerings meet these key needs, but many fintech companies are engaged in providing financial services outside of lending (such as money transfer, payments, savings, financial management tools) which either already do, or are positioned to meet key needs.

The OCC could map out a list of baseline financial inclusion goals, and permit institutions that already specialize in industries that meet the key needs of underserved populations. Such institutions should be prioritized for charters, where they can provide information about how their products and services already do accommodate underserved, or planning details for how they may expand current services to meet those needs in the immediate future. A special charter would also enable the expansion of product offerings for institutions that already demonstrate a competence or value structure that tend toward capability around financial inclusion.

Such banks would provide qualitative and quantitative evidence of core competencies aligned with financial inclusion, such as development power, responsiveness, affordability, usability, speed, transparency. In addition, they would provide a detailed business plan and risk assessment showing how their products either currently meet key needs, or can be expanded from the current business model to do so.

5. How could a special purpose national bank that is not engaged in providing banking services to the public support financial inclusion?

A first step in the wider project of financial inclusion is access to basic banking services. However, in our ideal world, even US consumers who do not use services such as investment and wealth management services would still benefit from an ecosystem of financial services institutions with market success based on responsive customer service, affordability, usability, speed, and transparency. These cultural values are growth drivers for the next generation of financial services, and a special charter empowering competent financial services institution to put those values to work for customers—whether underserved or not—will promote the kind of healthy competition and innovation that the OCC seeks.

6. Should the OCC use its chartering authority as an opportunity to address the gaps in protections afforded individuals versus small business borrowers, and if so, how?

Rather than creating bright line rules for how institutions should create technologies or design business models to meet specific needs, the OCC could set out certain general objectives, and allow competent institutions with values aligned with consumers to develop technologies that are responsive to market demands, and provide evidence of how the evolution of their products continue to be responsive to customer needs. Institutions are best placed to understand consumer needs, and the OCC should empower institutions who have demonstrated capability in responding to those consumer needs in responsible ways.

7. What are potential challenges in executing or adapting a fintech business model to meet regulatory expectations, and what specific conditions governing the activities of special purpose national banks should the OCC consider?

Many fintech business models are already designed to meet certain regulatory requirements. For example, MSBs may be required to keep a current inventory of permissible investments based on their transaction volumes. Or payment processors may be required to have all the appropriate licenses to offer local merchant acquiring to a market. Or equity-based crowdfunding may have to ensure that any participants are accredited investors that show an understanding of the risks of investment.

Active fintech companies are already aware of the regulatory challenges by operating in the financial services industry. As discussed in following commentary, most fintech companies are helmed by boards and executives with deep industry experience including former compliance officers who are familiar with regulations.

The OCC may want to consider a weighted approach toward governing the activities of special purpose national banks. For example, there is a clear difference between the activities of a financial institution with assets valued over $10B and those who simply meet capital requirements. As such, there are explicit provisions for those larger institutions under Dodd-Frank.

While a fintech company may obtain a special interest national bank charter, if it has a lower rate of market adoption and overall commercial activity or assets it shouldn't be governed to the same extent as larger institutions that have become fundamental to the financial system.

8. What actions should the OCC take to ensure special purpose national banks operate in a safe and sound manner and in the public interest?

The OCC should continue its approach to provide confidence that any nationally charted institution operates in a safe and sound manner.

As addressed in other questions, the OCC should continue with its baseline expectations when evaluating applicants for national charters. These expectations, though, should extend from providing a detailed business plan to understanding the intricacies of technological companies. Further attention should likely be given to the applicant's internal security procedures, data transmission and storage, ultimate beneficial owners, and venture funding, if applicable.

As with national banks, special purpose national banks should be open to periodic audits from regulators, which would the OCC. These audits, as they exist today, should be designed to ensure that charter-holders are following the approved business plans, business structure, and operational procedures.

However, the OCC may need to acknowledge— or provide an allowance for— modern interpretations of appropriate legislation. Technology is the base of fintech, and its application to regulation and the growing "regtech" industry should be considered.

In most cases, fintech companies will already be familiar to ongoing audits and regulator presence given existing federal and state-level expectations.

9. Would a fintech special purpose national bank have any competitive advantages over full- service banks the OCC should address? Are there risks to full-service banks from fintech companies that do not have bank charters?

In short, yes. It is likely that fintech special purpose national bank would have an advantage over full-service banks. And yes, there are risks to full-service banks from fintech companies that do not have bank charters. However, many of the advantages and risks live outside the concept of a national charter and it may be ill-advised for the OCC to address the advantages produced by fair market competition.

In considering the advantages of fintech companies, it is important to understand that technology-based companies have a vast advantage over non-technology based companies. While all financial companies use technology, not all financial companies develop technology. In other words, there is a distinction between national banks that buy or license technology and fintech companies that produce it.

Fintech strives to be modern, technology-driven, and demand-driven. This mindset allows fintech companies to develop and design products substantially faster than non-fintech institutions. Fintech companies can then reach production at shorter intervals and therefore answer market demand, and gain adoption, faster.

A national charter may enhance this advantage by removing regulatory overhead through standardization and a national footprint. For example, an MSB may not need to obtain a license from every state and unincorporated territory to have a national presence. But the national charter will introduce complexities that an MSB may not currently have, such as governance or liquidity requirements.

However, the natural advantages of fintech companies are tempered by two elements of national banks. First, national banks have terrific scale and experience. Most banks have decades of experience in the United States financial system as well as international financial systems. National banks productized many of their services and operations, can open their back-end services, and can provide that value through the payment chain. Most fintech companies, even with the benefits of a special purpose national bank charter, will not be able to rapidly reach that scale.

Second, national banks have undeniable brand recognition, and are generally trusted institutions. Because of their presence over the last 150 years, national banks are the face of the financial system. And while current consumers may not maintain the same relationship with national banks and their retail brick-and-mortar operations there is still a clear association between national bank branding and financial services.

10. Are there particular products or services offered by fintech companies, such as digital currencies, that may require different approaches to supervision to mitigate risk for both the institution and the broader financial system?

In recent years, digital currencies have been a much-debated topic in fintech. Namely, discussions center on the benefits of a digital currency verses the benefits of the protocol atop which digital currencies sits. However as both the currencies and their protocols develop, they will require different approaches to supervision.

One key aspect of digital currencies and their protocol is the concept of real-time payments. The United States, despite being such a large financial market, is lagging in provision of and support for real-time payments. As consumers turn away from traditional banking toward fintech for faster payments and services, regulators will face new challenges to both institutions and their movement of capital, and the broader financial system.

Another example could be the rise of push-payment systems. In the United States, the consumer or retail financial system developed a preference for pull-payments. These are instances where one party pulls funds from another, such as in payment card transactions or direct debit transfers.

Pull-payments pose higher consumer fraud risks and higher costs, given the role of intermediaries needed handle transactions. These payments are also slow and sit on old technology infrastructure, such as the Automated Clearing House (ACH) system. As a result, the fintech sector is looking towards more modern pull-payments.

Fintech companies are apt to take note of emerging markets and their preference for push-payments. As well, they are likely to see increased domestic demand for faster and cheaper financial systems. The result will be highly mobile products and services that encourage direct participation and that sit on re-imagined financial rails.

The early examples of products exist. Although ensconced in a pull-payment system, near field communication (NFC) payment products are launching and gaining market adoption in the United States. They are designed for speed and mobility, and NFC payment methods, including Apple Pay, Android Pay, and contactless cards are poised to change consumer preferences.

Additionally, preliminary examples of push-payments are beginning to appear. While mobile phones have served as payment methods for several years, fintech companies are beginning to exploit smartphone technology and open wallets. Having balance on mobile phones or within mobile applications, consumers are now in a powerful position to push payments to each other and to merchants. These are fast, low risk, and cheap direct payments. And if consumers continue to adopt them, they will change point of sale payments, online payments, and likely reduce the need for physical currency.

11. How can the OCC enhance its coordination and communication with other regulators that have jurisdiction over a proposed special purpose national bank, its parent company, or its activities?

First, the OCC should look to enhance its coordination and cooperation with other regulators. The main benefit will come from clearer communication and policies and a transparency in data or information flows between regulating entities. The existing framework between the Federal Reserve (the Fed), the Federal Deposit Insurance Corporation (FDIC), and the Consumer Financial Protection Bureau (CFPB) will likely not be adequate to handle the dynamics of the fintech industry.

As all four bodies are currently involved in the regulation of national banks and federal savings associations, the OCC should include opinions from the other three bodies as it seeks to define a charter for special purpose national banks relating to the fintech industry. The OCC provides that special purpose national bank charters may be tailored to the scope of the applicant. Therefore, it is possible that a fintech's charter excludes it from some regulatory requirements of the other regulators. There must be a consensus between all regulatory bodies of this positioning.

For example, if an MSB, under a special purpose national charter, is not held to the same requirements as a national bank— How would the Fed look to engage with the MSB if it sought to establish an account within the Fed and connect to national financial systems via FedACH or FedWire programs?

In this example, the Fed would need to have a basis to understand the intricacies of the charter. Definitions on why certain provisions exist or do not exist, how the OCC evaluated the application, etc. Without a transparent data and information flow, the aspired benefits of the charter program may not be fully realized.

However, the coordination and communication likely need to extend beyond the federal level of regulators. Following the MSB example, the OCC will be expected to coordinate with state-led agencies and offices and their licensing programs. Through a national charter, MSBs would likely be excluded from the past state-led supervision. The OCC will also need to consider how such a transition would take place and how states may view variances between the charter and their licensing programs.

12. Certain risks may be increased in a special purpose national bank because of its concentration in a limited number of business activities. How can the OCC ensure that a special purpose national bank sufficiently mitigates these risks?

It is natural that a special purpose national bank may have preliminary core product. As discussed previously, a limited number of business activities should be typical within the technology industry. For a higher probability of success, it is common for companies to avoid increasing their scope beyond a core product or small group of products. Without a sharp focus on a single offering, or limited offerings, a new company will struggle to find its differentiation in a market or to break into an existing industry.

Currently, the OCC expects a highly detailed business plan from all applicants. As stated, “These baseline expectations stress the importance of a detailed business plan, governance, capital, liquidity, compliance risk management, financial inclusion, and recovery and resolution planning.” Through a business plan the OCC seeks to understand the overall risk of the applicant, and perhaps more importantly, their ability to self-identify that risk and provide mitigation.

These baseline expectations should also be required for any special purpose banks. Unlike other technology sectors, fintech companies are generally formed from within the financial industry and with a pre-existing revenue model in place. And leadership within fintech senior executives generally has roots prior experience in the industry. They are former fund managers, bankers, and compliance officers, and consultants.

These two traits already give fintech advantages. With a functioning revenue model and the in-depth understanding of the industry, a robust and accurate business plan is the backbone of any fintech company. And the OCC should seek to see both emphasized in the plan and productizing of a special purpose national bank.

Outside of their base revenue models, fintech may also seek to raise additional funds or working capital through the venture funds market. The OCC should also consider this aspect of fintech when evaluating the potential risk. In general, the OCC could see venture funding as a safeguard: investors will want to see a return on their investment and will push for profitability.

The OCC should look see a balance, though, between the revenue model and the need for capital by distinguishing between required and opportunistic funding, and by setting clear expectations for the business plan to demonstrate appropriate commercial soundness based on solely the limited business activity.

13. What additional information, materials, and technical assistance from the OCC would a prospective fintech applicant find useful in the application process?

The OCC's *Comptroller's Licensing Manual Charters Booklet* sets out the basic outline of how a charter is approached by both the entities seeking them and the OCC. However, as has been widely discussed, these special interest charters are not the same as the OCC's current practice. Nor will they be standard, but instead tailored to the industry of the fintech applicant.

Looking outward toward other markets, such as the United Kingdom, it is possible to see an outward presence from regulators, such as the Financial Conduct Authority, in the fintech community. Commonly this presence manifests as the establishment of a national advisement program or physical presence in fintech incubators or fintech accelerators.

As the OCC looks to extend this charter service to the fintech industry, more dialog and presence within the industry will be useful.