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 ideas and real-world problems.

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.
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. These “fintech banks” will enjoy all of the relevant powers granted to national banks under the National Bank Act and will be subject to supervision by the OCC. In response to the OCC’s proposal and request for comment, 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.

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.

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.


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

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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.
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.treasury.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.
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,” provide detailed plans for products and services, and “obtain approval, or no objection, from the OCC” for material departures from these plans. 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. 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. 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.

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 standards should apply.

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17. Ibid., 9.
18. Ibid., 13.
19. Comptroller Curry’s Remarks, 5
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.” The proposal also worries about risks from unchartered fintech banks. 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. 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. 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
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. National banks are also able to export the usury laws of their home state to other states in which they do business. 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.

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. 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.

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.

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. 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, the OCC could draw on the economic evidence favoring regulatory federalism.

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)].
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.\textsuperscript{35} The proposal would have allowed state banks to be governed for banking law purposes solely by their home states.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.”\textsuperscript{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

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\textsuperscript{35} Interstate Banking; Federal Interest Rate Authority, 70 Fed. Reg. 60019 (proposed October 14, 2005).
\textsuperscript{37} OCC Proposal, 6–8.
\textsuperscript{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.”
\textsuperscript{39} OCC Proposal, 3–4.
\textsuperscript{40} Bureau of Consumer Financial Protection, Project Catalyst, accessed January 3, 2017.
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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.