Despite a Legal Setback - States Continue to Move Forward in Fintech Innovation

By Joann Needleman, Thomas A. Brooks / May 08, 2018

For more than two years, the Office of the Comptroller of the Currency ("OCC") has studied the regulatory impacts of innovations in financial technology. In March, 2016 it published a white paper regarding innovation in the financial services industry; in December, 2016 it went further and published another white paper describing what could be the baseline supervisory requirements of a Special Purpose National Bank ("SPNB"); and in March, 2017 it published a draft supplement to its licensing manual which suggested that non-deposit fintechs could eventually obtain a national bank charter. The Conference of State Bank Supervisors ("CSBS"), a nationwide organization of state banking and financial services regulators, sued the OCC to prohibit it from issuing a SPNB charter. The federal district court dismissed CSBS's claim, but this has not halted efforts by several states to provide for greater fintech innovation within their jurisdictions.

The court's decision against CSBS was similar to the finding in an unsuccessful suit brought against the OCC by the New York State Department of Financial Services in 2017. Like the claims in the New York case, the CSBS asserted that:

- the OCC does not have statutory authority for the Nonbank Charter Decision;
- the OCC does not have statutory authority for a corresponding regulation;
- the Nonbank Charter Decision failed to follow appropriate rulemaking procedures;
- the Nonbank Charter Decision was arbitrary and capricious; and
- the Nonbank Charter Decision violated the Tenth Amendment.

In the recently decided case, the court found that CSBS did not have standing to sue because it did not demonstrate either an injury-in-fact, or the possibility of an injury at this stage of the proceedings, to itself as an organization or to any member of the organization.

In addition to the question of standing, the court found that the dispute was not constitutionally or prudentially ripe for determination, first on a constitutional analysis, because CSBS failed to show any injury-in-fact either to itself or any of its members.

The court determined that the case also was not prudentially ripe, saying "the prudential ripeness doctrine asks two questions: (1) whether the issues are fit for judicial decision; and (2) whether "withholding a decision will cause 'hardship to the parties'."

Based on the record before the court, the court found that the OCC's supplement to its chartering manual remains in draft form, awaiting subsequent updates. Consequently, "if the OCC elects to adopt and apply a regulatory scheme to a particular Fintech charter, then the agency action will become sufficiently settled and courts will have a more concrete setting to resolve the legal disputes. In these ways, the dispute is not yet fit for judicial decision." Regarding whether withholding a decision might cause hardship to the parties, the court determined that since the decision-making by the OCC was not yet complete and that CSBS made no attempt to offer a reason why delay would cause it hardship, let alone that any hardship would be immediate and significant, it found that "the prudential ripeness doctrine counsels in favor of allowing time to sharpen this dispute before deciding it. Indeed, there may ultimately be no case to decide at all if the OCC does not charter a Fintech."

What does this decision mean for the future of a new OCC SPNB charter or the ability of states to compete effectively in the competition to license and regulate fintech entities?

Since the idea of a SPNB was introduced by Comptroller Thomas Curry, the OCC has been led by an Acting Comptroller, Keith A. Noreika, as well as a newly confirmed Comptroller, Joseph Otting. Mr. Nroeika's position last year was that "OCC has not determined whether it will actually accept or act upon applications from nondepository fintech companies for special purpose national bank charters." Mr. Otting recently stated that the OCC expects to release its position on the charter in the coming weeks. He has been quoted in the past as saying that "I'm not sure what it looks like, and how it's funded, but I do think there's a space there that a technology solution can solve." The OCC's position remains to be seen, but it has spent an enormous amount of time and personnel in creating the environment and regulatory parameters where a SPNB could exist.

How have the states responded to the challenges of creating an environment for fintech entities to flourish on their own or to partner with traditional depository institutions? Notwithstanding the failed effort by CSBS to object to the efforts of the OCC to create a SPNB, states are moving forward on their own to create an environment to make it easier for fintech entities to continue to be licensed and chartered by states.

One of the problems for fintechs is that in order to do business in the various states, they have to obtain licenses in each state, which is costly and time consuming. To make it easier, seven states have streamlined the process for obtaining approvals by fintech entities to do business in their states. While not offering complete reciprocity, these states are attempting to make it easier for payments companies, currency exchanges and other non-bank financial services entities by allowing approval by one state to be accepted by the other states.

In a first time action by a state, Arizona recently passed legislation to create an experimental Regulatory Sandbox Program that would enable a person to obtain limited access to the market in Arizona "to test innovative financial products or services without obtaining a license or other authorization that otherwise might be required." While the details of this new program are being determined, it is designed to allow for the use or incorporation of new or

emerging technology to address a problem, provide a benefit, or otherwise offer a new product, service, business model or delivery mechanism.

Similarly, Illinois is moving to create its own regulatory experimental space. On April 27, 2018, the Illinois General Assembly passed the Regulatory Sandbox Act by a vote of 93-4. The Illinois proposal would create a regulatory testing ground to enable persons to obtain limited access to the Illinois marketplace in order to try out innovations in financial products or services. It provides requirements to enter the regulatory sandbox and how an innovation might operate in that environment. The bill currently is under active consideration in the Illinois Senate.

Historically, consumers have benefited from the competition that is a product of our dual banking system. Paying interest on checking accounts was the result of the development of NOW accounts in New Hampshire. Regional compacts in the Northeast and Southeast predated interstate banking. Disclosure of credit card interest rates, annual fees, holding periods, and transaction charges all started in the states, and were later adopted by Congress at the federal level.

Whether or not the OCC will proceed in its efforts to incorporate the innovative use of technology in granting SPNB charters to non-depository entities, it is clear that states are responding to the needs of the fintech industry by trying create an environment that fosters the innovative use of technology in financial services.

If you would like additional information regarding the changes that are occurring in the fintech industry at the federal and state level, please contact Tommy Brooks at tbrooks@clarkhill.com, 202 552 2356 or Joann Needleman at jneedleman@clarkhill.com, 215 640 8536.