

Court Halts, At Least for Now, The OCC's FinTech National Bank Charter Program

by Joseph Lynyak and Helen Jiang

On Thursday, May 2, 2019, Judge Victor Marrero of the Southern District of New York issued an important decision in the closely watched *Vullo v. Office of the Comptroller of the Currency et al.*, No. 1:18-cv-08377. Judge Marrero allowed the lawsuit between the New York State Department of Financial Services (the “DFS”) and the Office of the Comptroller of the Currency (“OCC”) to proceed, thereby halting, at least for now, the OCC’s plan to start accepting applications for issuing special-purpose national bank charters (“SPNB charters”) to non-bank financial technology (“FinTech”) companies.

The decision can be viewed in one of two ways: a victory for federalism and the dual banking system, with New York State’s banking regulator—the DFS—resisting the efforts of the federal banking regulator—the OCC—to legislate by way of administrative agency fiat; or as an unwelcome development in the efforts to move towards comprehensive, standardized regulation of FinTech companies.

Background

The DFS had previously sought to challenge the OCC’s SPNB charter program, but that effort was thwarted when the then-presiding judge dismissed the DFS’s lawsuit because it was not yet ripe for adjudication. Then in July 2018, the OCC announced that it had authority under the National Bank Act (the “NBA”) to start accepting and reviewing applications for SPNB charters for FinTech companies. Shortly afterwards, DFS renewed its challenge, filing its complaint in September 2018 seeking to have the OCC’s SPNB charter program voided. DFS alleged that OCC exceeded its authority under the NBA (Count I), exceeded its statutory authority to promulgate regulations to allow it to issue SPNB charters (Count II), and violated the Tenth Amendment of the U.S. Constitution by creating a conflict with state law that Congress did not authorize (Count III).

In its complaint, the DFS alleged that the OCC’s SPNB charter program would undermine New York’s ability to regulate and protect its financial markets and consumers by allowing FinTech companies holding SPNB charters to operate nationwide without the

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burdens of facing state-by-state regulations, and without the cost and expense of providing deposit services. According to the complaint, the OCC's program essentially "exempts...new fintech chartered entities from existing federal standards of safety and soundness, liquidity and capitalization."

The gravamen of the DFS's complaint is the recognition of the significant role state banking regulators play in regulating non-bank financial services. Among other things, the DFS examines and regulates 229 state and international banks, as well as approximately 600 non-bank financial services companies. The OCC is an office of the U.S. Treasury and the regulator of federally chartered national banks pursuant to the NBA.

The Decision

Judge Marrero found that DFS's renewed lawsuit was ripe, and he denied the OCC's motion to dismiss with respect to Counts I and II. In a press release issued following the decision, Acting DFS Superintendent Linda A. Lacewell called it a "resounding triumph," which would help "to achieve a level playing field for regulated banking institutions."

Judge Marrero first found that the DFS has sufficiently established standing for its constitutional and statutory claims and that the claims as alleged in the complaint were ripe. In particular, the Court determined that the DFS had demonstrated a substantial risk that harm would occur should the current balance of the dual banking system be upset by the OCC's SPNB charter decision. Among other things, the Court identified potential harm New York citizens would endure by losing the comprehensive protections currently provided by the New York banking law, the risk of New York's regulations for over 600 non-bank financial services firms "becoming null and void," as well as the direct economic harm caused by the perceivable deprivation of revenue which the DFS could generate through future licensing assessments.

As to the last two harms, the Court found that "based on DFS's allegations about the threats of federal preemption and the unique characteristics of the dual banking system, DFS faces the current risk that entities may, at any moment, leave its supervision to seek greener pastures."

With regard to the merits of the case, the Court disagreed with the OCC's contention that the DFS's statutory challenge should fail because the OCC reasonably interpreted the ambiguous language in the NBA mandating it to determine whether an applicant for a national bank charter is entitled to commence "the business of banking" to include non-depository institution applicants. After carefully considering the plain language of the NBA, history, and legislative context, the Court found that the business of banking "unambiguously requires receiving deposits," limiting the eligibility of applicants for OCC national bank charters only to depository institutions.

Notably, the Court's analysis discussed at length the history of NBA's drafting, where "Congress relied heavily on New York's experience derived from the operation of its Free Banking Act and the Act's language," referencing the historical approval and disapproval

of various bank activities in New York to determine the scope of “the business of banking.” Though the Court conceded that some degree of ambiguity exists as to the outer limit of this phrase, it rejected the contention that the indispensability of deposit-receiving to the business of banking is ambiguous.

The Court, however, found that the DFS had failed to state a Tenth Amendment claim because an action that violates the Tenth Amendment is one that is categorically beyond federal authority, namely, an action the Congress simply cannot choose to take.

The full decision can be found [here](#).

Implications

There are a number of near- and medium-term implications of the decision.

First, because the Court’s decision allows the DFS’s lawsuit to proceed, the OCC will not take any further action in regard to its SPNB charter decision, such as accepting or reviewing SPNB charters applications.

Second, for FinTech companies, it means that they will continue to be required to comply with state law licensing and similar obligations based upon their business plans.

Third, for banks, the decision preserves their franchise in the U.S. financial services industry, and denies to FinTech companies what was viewed by many critics as an unfair and unearned competitive advantage without regulatory oversight and compliance obligations.

Fourth, for the OCC, the decision further postpones similar challenges that might be brought by other state banking agencies, and may afford the OCC the opportunity to revisit the merits of its SPNB chartering decision *ab initio*.

Finally, for the DFS, the ruling vindicates its decision to challenge the OCC’s SPNB charter program and indicates that the dual-banking system, which has existed for more than 100 years, is alive and well.

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