



NASCUS National Meeting 2021

Michael Townsley
CSBS Director, Regulatory Policy & Policy Counsel

March 17, 2021



Future of Payments Systems

Cover two topics related to the Future of Payments Systems:

(1) The OCC's effort to create the so-called "fintech charter" to enable fintechs to obtain access to the Federal Reserve payments system

(2) Access to Federal Reserve payments systems by nontraditional institutions more generally

Fintech Charter

What is the Fintech Charter

OCC Chartering Authority

Fintech Charter Litigation

Latest Fintech Charter Developments

What is the Fintech Charter?

A new type of special purpose national bank charter first announced in 2016. Goal is to give all the benefits of being a national bank without any of the associated burdens.

Benefits Obtained

- Preemption
- Single Federal Regulator
- Potentially Federal Safety Net Access (Payments System, Discount Window)

Burdens Avoided

- FDIC approval (Deposit Insurance) and Fed Approval (Bank Holding Company Act)
- Regulations applicable to FDIC-Insured Banks (e.g. Community Reinvestment Act, Basel III)
- Consolidated regulation by Fed at Bank Holding Company level

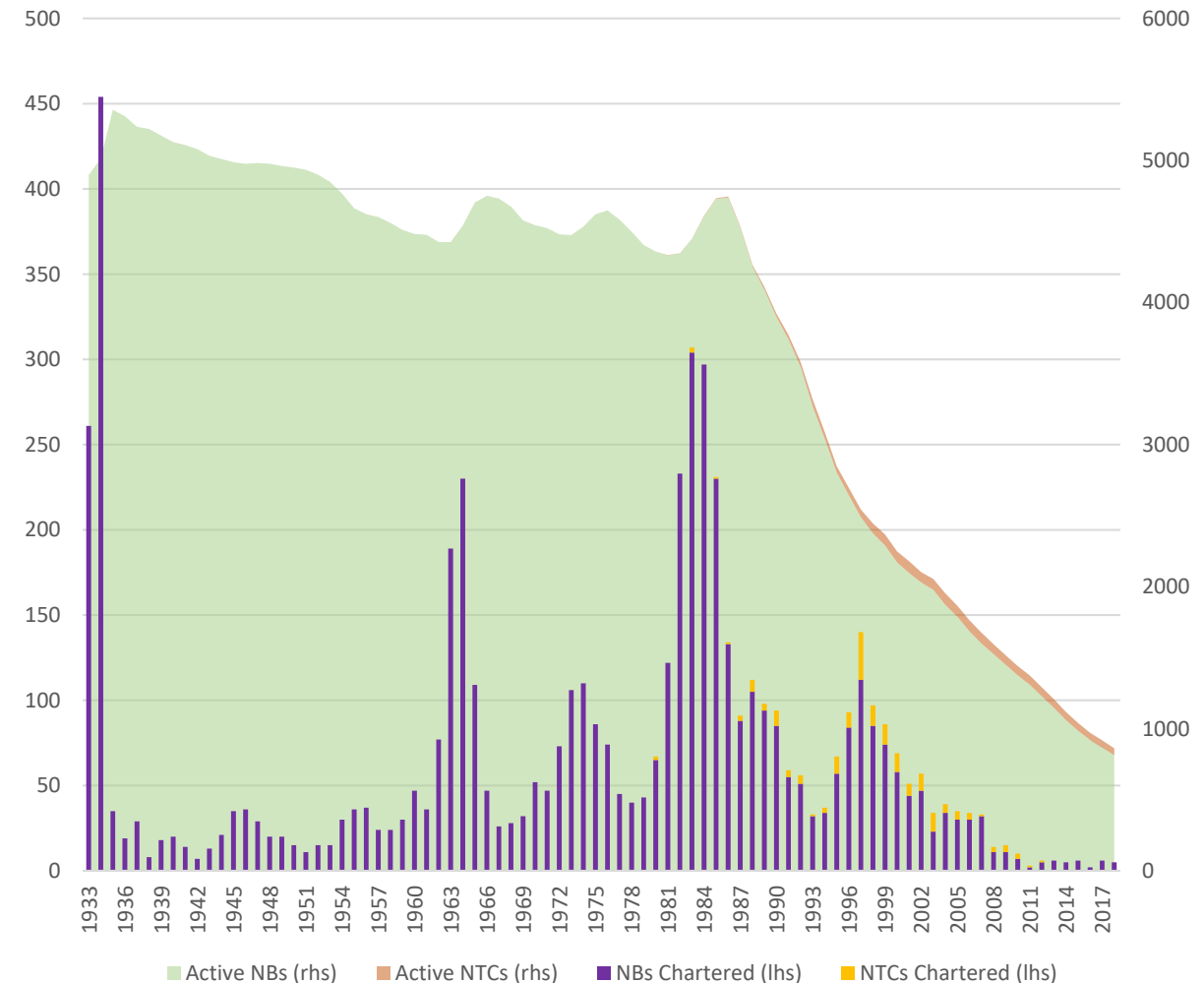
What is the Fintech Charter?

How are these burdens avoided? By arguing that deposit insurance is optional for national banks.

But deposit insurance mandate imposed on national banks by Section 2 of the Federal Reserve Act (12 USC 222).

“Every national bank in any State shall, upon commencing business . . . become a member bank of the Federal Reserve System . . . **and shall thereupon be an insured bank under the Federal Deposit Insurance Act**, and failure to do so shall subject such bank to the penalty” of charter forfeiture.”

National Banks and National Trust Companies: Active & Chartered 1933-2018



OCC Chartering Authority

The NBA provides the OCC with the authority to charter the following types of institutions:

- 1) National Banks organized to carry on the “business of banking” which requires (at a minimum) receiving deposits; and
- 2) National Trust Companies organized to carry on a trust business -- limited to exercising fiduciary powers.
- 3) National Bankers Bank organized to carry on a correspondent banking business.

Distinction between special purpose charters and narrow-focus institutions (e.g., credit card banks).

OCC relied on business of banking chartering authority to create the fintech charter.

OCC Chartering Authority: Fintech Charter

- OCC relied on its chartering regulations to argue that a national bank need not engage in receiving deposits.
 - 12 C.F.R. 5.20(e)(1): OCC may charter a national bank so long as it conducts “at least one of the following three core banking functions: Receiving deposits; paying checks; or lending money.”
- Concedes that national banks are required to be FRS members
- But asserted that a national bank is required to be FDIC-insured only if it engages in receiving deposits.



Section 16 of the Federal Reserve Act:

“ . . . said notes shall be obligations of the United States and *shall be receivable by all national and member banks*”

“[I]t is required that every bank in the system shall receive the notes *on deposit at par.*”

Fintech Charter Litigation (cont.)

CSBS & NYDFS
initiated separate
legal challenges

In May 2019, SDNY
denied OCC's
motions to dismiss.

In October 2019,
SDNY issued a final
judgement setting
aside Sec.
5.20(e)(1).

OCC appealed to
Second Circuit.
Case now fully
briefed.

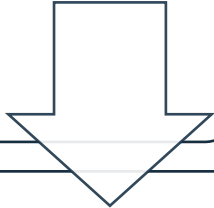
"The Court concludes that the NBA's "business of banking" clause, read in the light of its plain language, history, and legislative context, unambiguously requires that, absent a statutory provision to the contrary, only depository institutions are eligible to receive national bank charters from OCC."

"A key feature of the dual banking system is that, with certain exceptions, any entity that is not a deposit-receiving bank --including non-depository fintech companies -- is left largely to the prerogative of the states to regulate."

Latest Fintech Charter Developments

In **September 2020**, Acting Comptroller announces OCC accepting applications for “payments charters”

- **New label largely a rebranding effort, not a shift in legal justification.**
- **Payments Charter 1.0: Preemption**
- **Payments Charter 2.0: Payments System Access**



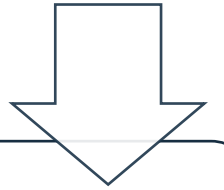
In **November 2020**, OCC accepts application from state-licensed mortgage company, Figure Lending, LLC, to organize a noninsured national bank, Figure Bank, N.A..

- **Figure Bank would purportedly accept deposits from institutional investors but would not be FDIC-insured.**



In **December 2020**, CSBS refiles litigation to stop OCC from approving Figure charter application.

Latest Fintech Charter Developments (cont.)



In **January 2021**, OCC issues Interpretive Letter 1176 to expand its authority to charter national trust companies by enabling them to engage in banking and nonfiduciary activities.

- Superseded court and OCC precedent providing that national trust companies are limited to exercising powers which are “fiduciary” within the meaning of the NBA.
- Under the NBA, custody activities are banking powers, not fiduciary powers.
- Based on IL 1176, OCC approved the conversion of two state-chartered trust companies engaged in custody of digital assets.
- OCC attempting to use trust company chartering authority to do what it has not succeeded in doing with its bank chartering authority.

Fed Payments System Access

Direct Access to the Federal Reserve Payments System

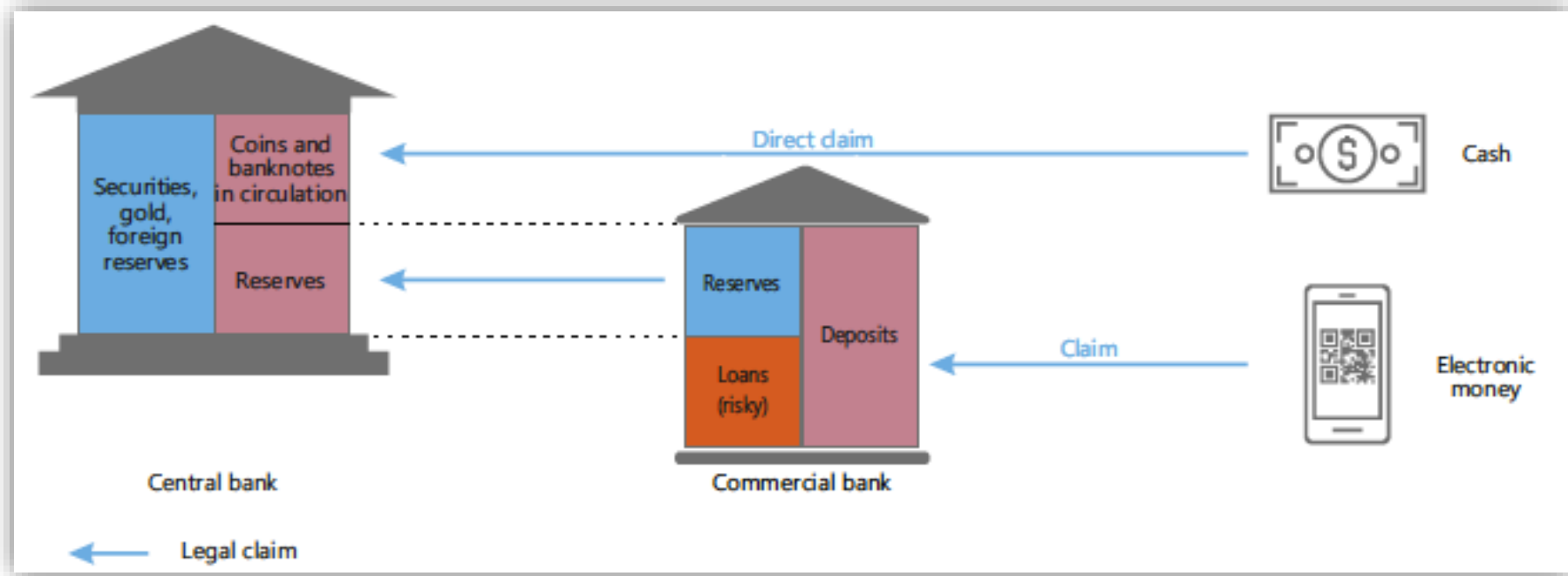
Who is Eligible for Direct Access?

Direct Access by Nontraditional Institutions: Legal & Policy Questions

Direct Access to the Federal Reserve Payments System

- Direct access to Federal Reserve payments systems (e.g. Fedwire, FedACH) obtained by opening a “**master account**” with a Federal Reserve Bank.
 - **Master account** is an account with reserve and clearing balances on the books of a Reserve Bank.

➤ These balances constitute “central bank money” in the form of deposit liabilities of the Fed Reserve as opposed to “commercial bank money” (deposit liabilities of a commercial bank)



➤ Central bank deposit money is the main settlement asset in the U.S. payments systems.

- Direct access to the payments system = Direct access to central bank deposit money

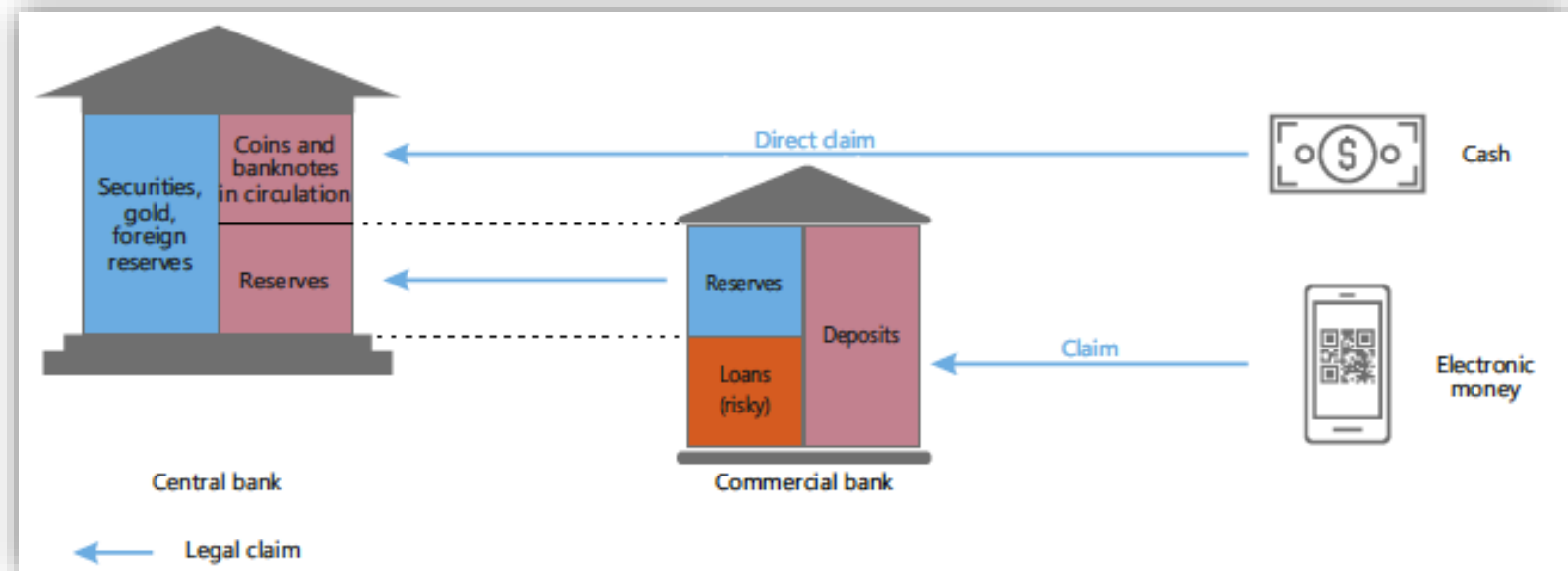
Direct Access to the Federal Reserve Payments System

Direct access to Federal Reserve payments systems (e.g. Fedwire, FedACH) obtained by opening a “**master account**” with a Federal Reserve Bank.

Master account is an account with reserve and clearing balances on the books of a Reserve Bank.

- These balances constitute “central bank money” in the form of deposit liabilities of the Federal Reserve as opposed to “commercial bank money” (i.e. deposit liabilities of a commercial bank)
- Central bank deposit money is the main settlement asset in the U.S. payments systems.

Direct access to the payments system = Direct access to central bank deposit money



Who is Eligible for Direct Access?

Entities eligible for master accounts = entities subject to reserve requirements imposed by Federal Reserve Act (FRA)

Prior to Monetary Control Act of 1980 (MCA):

- Reserve requirements imposed only on Fed member banks
- Direct access limited to Fed member banks, and by extension, FDIC-insured banks

After MCA:

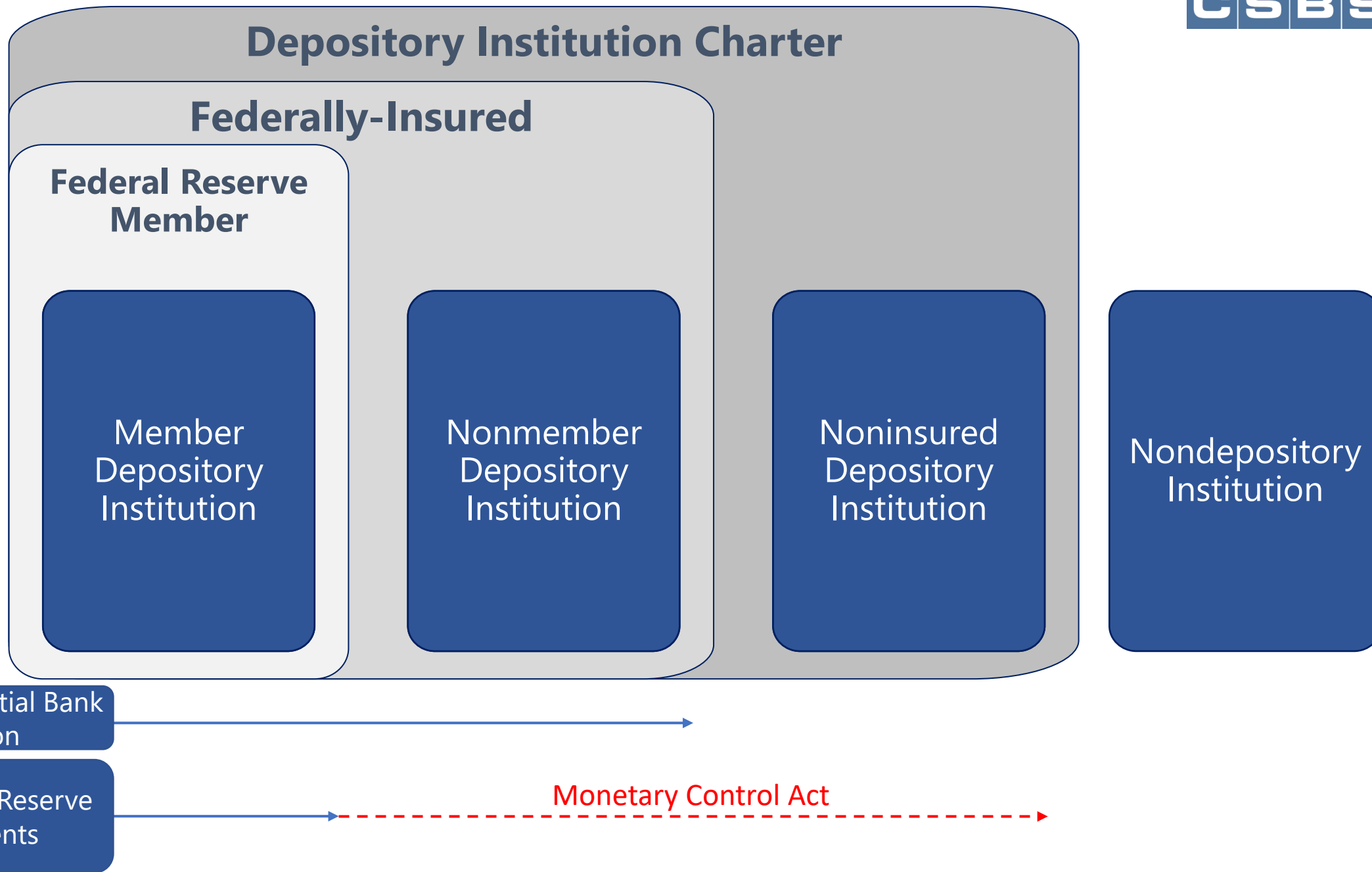
- Reserve requirements imposed on all “depository institutions”.
- Direct access available to Fed member and nonmember depository institutions, including noninsured institutions

“Any Federal reserve bank may receive from any of its member banks, or other depository institutions, . . . deposits of current funds in lawful money, . . .”

- Section 13 of the FRA (12 USC 342)

Section 19 of the FRA (12 USC 461) defines “depository institution” to include, in relevant part:

- Any federally-insured depository institution (commercial bank, thrift, or credit union); OR
- Any institution “eligible to make application to become” a federally-insured depository institution.



Who is Eligible for Direct Access? (cont.)

How does a noninsured institution know whether it is a “depository institution” eligible for a master account?

- **Being covered by reserve requirements not sufficient because of the manner in which they are imposed by the Fed.**
- **In the case of a noninsured bank, must look to the Federal Deposit Insurance Act (FDIA).**

To be “eligible to make application to become” an FDIC-insured bank, must:

(1) Be chartered as a “bank”

- “FDIC will look to the characterization of the institution by the laws under which the institution is created.”

(2) Be “engaged in the business of receiving deposits, other than trust funds”

- “Maintain one or more non-trust deposit accounts in the minimum aggregate amount of \$500,000.”

Direct Access by Nontraditional Institutions: Legal & Policy Questions

Numerous legal and policy implications raised by noninsured institutions seeking master accounts/direct payments system access...

In the case of a noninsured bank, what agency determines whether it is eligible to apply for FDIC-insurance (Fed or FDIC)?

- **Legal problems arise if the Fed makes determinations**
- **Practical problems arise if FDIC assumes this role.**

How much discretion does Fed have to deny master accounts?
And does this discretion sit at the Board or Reserve Bank level?

- **Issue has been litigated to some extent in the case of Fourth Corner Credit Union and case of The Narrow Bank**

Direct Access by Nontraditional Institutions: Legal & Policy Questions

If you think the Fed has no discretion and is required to grant master accounts to any noninsured institution which is a "depository institution",
then what about...

- Payments system risk?
- Separation of banking and commerce/ extension of the federal safety net to commercial enterprises?
- Principles of regulatory fairness?

Or if you think the Fed has some discretion and, to mitigate these concerns, the Fed should condition access by imposing regulatory/ supervisory tailored to individual applicants,
then what about...

- Fed's regulatory/supervisory role vs. payments system operator role?
- Risk of nontransparent decision-making/ inconsistent treatment?

Direct Access by Nontraditional Institutions

The Role of Central Bank Money in Payment Systems:

“Limits on access to banks can also reflect a conscious desire to maintain a balance of privileges and responsibilities between regulated and unregulated institutions. In such countries, access to central bank accounts is regarded as part of a "package" of privileges and burdens given to banks. The "privileges"--including access to accounts and to credit, and in some cases participation in deposit insurance schemes and the ability to take part in monetary policy operations--are granted in part to give an incentive to institutions to undertake the "burdens" of banking regulation and supervision, including capital and reserve requirements.”

CONTACT US



mtownsley@csbs.org



Conference of State Bank Supervisors
1129 20th Street NW
9th Floor
Washington, DC 20036

