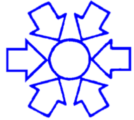 Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

DATE: September 11, 2020

In a series of sometimes blistering comments and commentaries, Acting Comptroller Brooks has made it very, very clear that he plans to put a high-tech stamp on the national-banking charter for as long as he holds the OCC's seal. Many think that Mr. Brooks' goals are principally a renewed fintech charter, a new payment charter, and a very buff national-bank construct. However, comments to *Politico* show a still more ambitious and even more structural goal: redefining federal banking regulation from one focused on entities to one governing activities. The charters under the OCC's purview would then become little more than umbrellas in which a wide range of activities are conducted in accordance with standards specific to each one, not to national banks as a whole. This is an even more radical redesign of the federal framework than most commentators have contemplated, for it's a revolutionary idea. Like most revolutions, it would change the landscape permanently even if a subsequent Comptroller foments a restoration.

In his *Wall Street Journal* op-ed on Wednesday, Mr. Brooks and his newly-minted chief economist, Charles Calomiris, observed that deposit-taking is not intrinsic to banking because early 19th-century banks didn't necessarily take deposits. They also didn't offer mobile banking, making an extrapolation from 1830 to current banking-market conditions most uncertain. However, Messrs. Brooks and Calomiris are right that some banks of more recent vintage also funded themselves with non-deposit sources. Indeed, with the agency's approval two weeks ago of the Jiko bank acquisition, the OCC is again authorizing banks with new, non-deposit models.

Still, even the Jiko bank takes insured deposits, with access to FDIC insurance and thereby to the payment system still a critical and virtually-universal charter bulwark. Quite simply, there's no reason to be a bank in any financial line of business unless one of the special privileges provided under law only to banks offsets all the costly rules demanded only of banks.

If the benefits of bank charters were not manifest and manifold, no one would want to take advantage of them via "rent-a-bank" arrangements. Indeed, these arrangements are the best of both worlds to investors in the landlord bank and the tenant "partner." However, the fact that safety-and-soundness and consumer-protection rules usually stop at the bank's virtual door makes these arrangements nothing more than adroit arbitrage operations using taxpayer-provided benefits for services far afield from those for which the benefits were granted.

It's of course true in one sense that a loan from a bank is the same as a loan from a fintech funded by a bank. However, the lack of CRA, capital, liquidity, resolution, and so many other protections means that the fintech loan in fact is different and often not just to the borrower, but even to the financial system as banks transition from intermediaries into enablers. Intermediation is a fundamental economic-growth engine; arbitrage isn't.

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A rebuttal to the need for entity-based bank regulation might be said to exist in the activity-based approach FSOC has now largely set for SIFIs. However, there isn't a unifying federal framework for like-kind activities such as asset management, payment, insurance, mortgage banking, and lending outside a banking charter. Often, companies in each of these business lines have little in common but a single shared business line in a maze of other financial and even commercial services. None of them owns an insured depository and, at least so far, none has dared rent a bank. Thus, what's good for one asset-management goose may well be anathema to another asset-management gander. SIFI designation was the entity-based approach to systemic-risk mitigation, but it ran aground not only because no company wants to be regulated like a bank if it can avoid it, but also because case-by-case designation was extraordinarily complex and, to some eyes, even capricious.

As Mr. Brooks seems to envision activity-based regulation, the national bank or federal savings association would become a mix-and-match affair, with the OCC authorizing case-by-case regulatory constructs based on the activities in which each company engages along with one or another of the bank-charter benefits with the greatest appeal. Even if this were not an invitation to more rented banks in the absence of more coherent cross-charter regulation, the prudential and consumer-protection attributes of each charter and their reach to parent companies could be both arbitrary and capricious in the absence of an entity-based construct. Without a clear construct on which comment is sought, it's simply impossible to tell who wins or loses in each activity and where taxpayer benefits and risk would start and stop.

One reason for rules is precisely to limit regulatory discretion so that favoritism, idiosyncrasies that lead to competitive advantage, and new risks are contained and, with good regulation, transparent. The licensing process is inherently idiosyncratic and opaque, making it a thoroughly inappropriate vehicle for regulatory innovation.

This isn't to say that the national-bank charter should stand still – the agency's proposal for new activities and its advance release on digital services creates a platform for orderly, transparent, equitable, and even essential reform. Special-purpose charters might even play a role in this evolution – they've done it before. However, evolution by edict is incompatible with both the rule of law and the proven risks of financial-system "innovation" outside the reach of prudential and consumer regulation. Mr. Brooks may feel "time's winged chariot" drawing nigh due to the election, but the Administrative Procedures Act and the due process it demands are there for a reason. The OCC can and should lead the way with great ideas, but Congress has established an entity-based construct for national banks and the agency cannot and should not alter it by fiat.