Financial Services Management

Federal-Charter Powers

Cite
OCC, Final Rule, Activities and Operations of National Banks and Federal Savings Associations

Recommended Distribution
Corporate Planning, Corporate Development, Policy, Fintech, Legal, Government Relations

Website
https://www.occ.gov/news-issuances/federal-register/2020/nr-occ-2020-158a.pdf

Impact Assessment

- The activities authorized for national banks and federal thrifts will be judged on a tech-neutral basis, expanding them now and laying the platform for still more expansive federal charters to come.
- Federal savings associations have largely parallel powers to national banks, making this charter more powerful for nontraditional thrifts.
- Banks could become significant market forces in tax-equity financing, avoiding the need to house these activities in limited BHC subsidiaries under more stringent regulation.
- Payment-system membership options are now open to more private, non-traditional, or foreign systems.
- BHCs with national banks are better insulated from hostile takeovers.
- Corporate-governance changes facilitate holding-company elimination.

Overview

In conjunction with a wide-open request for views on ways to increase the innovativeness of national banks and federal savings associations (FSAs),[1] the OCC has finalized a significant rewrite of their more traditional powers and activities. Although much of the lengthy rule is technical and codifies longstanding interpretations, several changes open existing activities to more flexible standards, provide more generous interpretation of exposures and risks, and represent an overarching effort to increase the ability of national banks and FSAs to offer new

[1] See **DIGITAL5**, *Financial Services Management*, June 9, 2020.

products and services regardless of the delivery channel – analog or digital. This policy thus revises and in some cases reverses the OCC's 2016 stand in which it, along with the FRB and FDIC, took a very cautious view of technological markets and nonbank powers.[2] The rule also expands payment-system membership options in ways that could advance new entities and revises national-bank governance rules to make it easier to eliminate parent holding companies, facilitating both more efficient national banks and innovative chartering arrangements.

Impact

Although much in this rule codifies prior interpretations and makes other modifications with limited strategic impact, its overall thrust is to give national banks and federal savings associations expanded powers. This is particularly true with regard to electronic delivery of a wide array of products and services, where existing caveats are eliminated and more expansive activities the OCC has long considered to be commercial may be possible. Definitions related to physical branches are also liberalized to enhance digital delivery. Expanded interest in both traditional federal bank and thrift charters may ensue along with wider scope for the special-purpose fintech banks previously authorized by the OCC[3] and payment and other special-purpose charters. This change follows others by the OCC to codify the valid-when made doctrine[4] and true-lender test[5] to make it easier for national banks and FSAs to be considered the lender in nontraditional "partnerships" with fintechs or other ventures, thus expanding federal preemption of state usury ceilings and consumer-protection standards. The extent to which federal charters may now further dissociate these lending activities from physical branches will strengthen these alliances and the resulting scope of federal preemption. This is highly controversial and may be rolled back by the OCC in a Biden Administration or by the next Congress.

Many states have "wild-card" statutes allowing state-chartered banks to enjoy powers accorded national banks, thus expanding the reach of the OCC's final construct. Unless or until the FRB and FDIC expand the scope of activities permissible in other state charters, federal charters are likely to be preferred even for entities without need of a national retail-delivery network, with this made even more compelling if the companion ANPR on digital activities increases the federal charter's scope still more dramatically.

Many aspects of this rule integrate the standards for FSAs with those for national banks, continuing the integration of rules launched when the Office of Thrift Supervision's jurisdiction was terminated and its authority transferred in part to the OCC under the Dodd-Frank Act.[6] In general, the rule makes the powers of federal savings associations parallel to those of national banks except to the extent statutory barriers require differentiation. The resulting framework thus allows federal thrifts to engage more freely and at greater scale in activities such as international finance, derivatives, and – consistent with the body of the OCC's combined proposals – digital delivery across the range of permissible banking services.

---

2 See *Client Report* **CHARTER23**, September 14, 2016.

3 See **FINTECH20**, *Financial Services Management*, August 3, 2018.

4 See **PREEMPT31**, *Financial Services Management,* December 2, 2019.

5 See **PREEMPT35**, *Financial Services Management,* November 2, 2020.

6 See **CHARTER21**, *Financial Services Management*, August 3, 2010.

As discussed more fully below, several provisions break new ground beyond the sharp shift to digital finance. They for example provide significant scope for federal charters to engage in tax-equity finance (TEF), including even fund structures in this complex and often profitable arena. To date, activities similar to TEF are housed in the merchant-banking subsidiaries of financial holding companies, subject to numerous restrictions.

The rule also provides greater scope for national banks to become payment-system members. This enhances their ability to join private payment systems and thus make private-sector challengers to FedNow more likely to succeed.[7] Because of the way the OCC has defined payment systems, these private payment systems could include not just current, bank-owned systems such as The Clearing House, but also payment systems established by nonbanks such as large payment processors or Facebook. Eligible payment systems are those defined as payment, settlement, and clearing systems not regulated in the U.S. by the SEC or CFTC, thus giving federal charters many possible systems among which to choose. The final rule does not specify terms or regulatory constructs for eligible systems, instead requiring prior or after-the-fact notices based on the liability and operational losses to which a bank could be exposed. Ongoing safety-and-soundness monitoring is also mandated, but banks would determine how best to remediate emerging risks unless the OCC decides to act on the basis of notices that may need to be filed in such cases.

As noted, the rule also addresses corporate governance. Giving federal charters a very broad choice of state corporate-governance domicile, this would permit choices that, as the OCC notes, reduce the need for a parent holding company. Although one large bank, Zions, pioneered ending its parent company in 2018,[8] few national banks have followed suit. This is in part due to remaining tax concerns, but the combination of broader powers authorized pursuant to this NPR and corporate-governance flexibility might increase the number of national banks electing to follow Zions' example. Non-traditional charters better able to operate without a holding company and the regulatory costs associated with it might also advance, especially if the FDIC expands its standards for eligible industrial banks.[9]

What's Next

This final rule was released on November 23; it is effective April 1, 2021. As noted below, the final rule clarifies that all of the powers of national banks, along with their duties and obligations, apply to federal branches and agencies of foreign banks. Although the NPR included at least one instance in which a particular power was expressly authorized for these entities, the final rule deletes many of these because commenters were concerned that this express injunction could lead to questions about which other powers in certain sections were in fact authorized for federal branches and agencies of foreign banks. In doing so, the agency now says it plans a future rulemaking addressing independent-undertaking authority but does not make it

7 See **PAYMENT17**, *Financial Services Management*, August 19, 2019.

8 See *Client Report* **CHARTER24**, November 16, 2017.

9 See **ILC14**, *Financial Services Management*, April 13, 2020.

clear if this rulemaking would be limited to this issue or more generally consider the scope of FBO powers via federal branches and agencies.

Analysis

The rules described below apply to national banks, FSAs, and federal branches and agencies of foreign banks. In addition to the matters discussed below, the rule also makes substantive changes to national bank hours, office-sharing arrangements, and operations.

A. Business of Banking

As noted, the OCC has redesigned its standards for approving activities considered to be the business of banking to make it technology-neutral, doing so by eliminating the current, separate list of permissible electronic activities and integrating it in the broader OCC standards and related list of approved activities. Doing so gives national banks broader scope to engage in services such as website development, providing email services for promotional purposes, and making equipment sales. Conversely, electronic-focused banks could now offer the full array of permissible banking products and services in analog or digital form as they may prefer. The rule retains the prior list of electronic activities expressly considered to be within the business of banking; as noted, the overall question of digital finance is under sweeping OCC review.

B. Finders' Fees

This section reorganizes national banks' finder powers to make them more clearly apply to electronic activities even as the parallel ANPR on digital services seeks views on expanding this definition. The rule also clarifies and expands finder powers for federal savings associations. As with national banks, these powers do not extend to otherwise-impermissible brokerage services, but finder's-fee services for FSAs remain more limited than for national banks due to governing law. A permissible finder's-fee arrangement must be incidental to an FSA's activities, with the final rule providing a broad definition of how this may be determined.

C. Place of Business

As noted, the OCC's rule codifies and in some cases expands a bank's footprint without the need for physical branches. These changes first clarify that national bank operating subsidiaries may distribute their own or the parent bank's loan proceeds directly to a borrower in person at the op-sub's offices without violating branching restrictions if the op-sub provides similar services to customers of unaffiliated banks. The rule also codifies and expands OCC policy providing broad scope to loan production offices. Rules governing when a financial-literacy facility housed at a school or community group is a branch are also liberalized.

Remote service units (RSUs) have also long been exempt from branch designation. The rule expands the RSU definition to include automated and unstaffed facilities and dropboxes. The rule also increases the flexibility of interactions between an RSU and LPOs or deposit production offices (DPOs). The OCC asserts in the final rule that none of these changes adversely affect CRA compliance because its CRA rule judges

a bank's assessment area by the location of any deposit-taking facility, not just physical branches.[10]

D. Tax-Equity Financing

TEF transactions are defined as those in which national banks or Federal savings associations provide equity financing to fund a project that generates tax credits or other tax benefits when the use of an equity-based structure allows the transfer of those benefits to the bank or FSA. TEF transactions deemed the equivalent of a loan and therefore permissible are expanded, although equity-holding and underwriting restrictions must still ensure that underwriting and other terms are generally loan-equivalent as determined by criteria detailed in the regulation. However, unlike the NPR, the final rule allows TEF to go through investment funds or other structures. In all cases, eligible TEF must last only for the "reasonable" amount of time needed to achieve tax benefits or the desired rate of return based on tax benefits, not investment or sales revenue.

This authority supplements and is additional to that for federal charters related to public-welfare and community-development investments, with banks allowed to pick the authority that best reflects the transaction they seek. In addition to other restrictions in the rule, all investments must be passive, but temporary management in foreclosure or under other circumstances is allowed.

TEF transactions must also be no more than five percent of capital and surplus in aggregate and no more than three percent to a single entity, with higher aggregate limits allowed with OCC approval. However, in no case could TEF exceed fifteen percent of capital and surplus. Prior notice is required for all TEF.

E. Payment-System Membership

The final rule significantly expands the ability of banks to join or create payment systems, making it clear that membership is permitted even if the bank or FSA shares in operational losses or is required by the system to hold reserves against losses. Payments systems are defined as done in the Dodd-Frank Act's definition of financial-market utilities (FMUs).[11] Payment systems meeting this definition for purposes of this rule may handle an array of payment, settlement, and clearing tasks for various financial instruments if the system is not among those required to be regulated by the CFTC or SEC if it is domiciled in the U.S. Payment systems are open to national-bank or FSA membership regardless of where they operate and whether they are wholesale or retail systems.

New payment-system memberships require thirty-day prior notice if the bank or FSA is exposed to "open-ended liability," defined to include indemnification commitments such as those required by the Fed. A month after-the-fact-notice is otherwise required. Risk limits suitable for the OCC may be found to exist if a written legal opinion

[10] See *Client Report* **CRA28**, May 26, 2020.

[11] See **PAYMENT11**, *Financial Services Management*, July 23, 2010.

determines this to be the case. Both of these notices must include a commitment to identify and measure risk upon joining and monitor and control it thereafter. Immediate notice to the OCC is required if a safety-and-soundness concern is identified for all payment systems covered by this rule, not just those a bank or FSA joins pursuant to its broader authority. In addition to notifying the OCC, the bank should also quickly mediate any identified risks.

F. Corporate Governance

1. Applicable Law

The rule substantively revises current governance standards put in place in 1996 and largely unchanged ever since. This construct still generally relies on federal law, but the final rule now alters it by allowing national banks instead to rely on applicable state law (i.e., that of the state of main branches or of other branches, of BHCs, Delaware, or under the Model Business Corporation Act). The changes give banks greater discretion over applicable law, reduce compliance burden, and facilitate operating as a national bank or FSA without a holding company by allowing the bank also to rely on the law of the state in which its prior holding-company was governed.

2. Anti-Takeover Proceedings

The OCC now also lays out its views on anti-takeover provisions, generally allowing these if authorized by applicable state law where the OCC deems them consistent with federal law and safety and soundness standards. The rule also details how this determination will be made and provides a non-exclusive list of acceptable provisions. However, the OCC reserves the right to accept state standards on a case-by-case basis, with banks also allowed to ask for the OCC's views prior to adopting a specific provision. The rule also lays out how national banks are to adopt these governance provisions.