ARTICLE

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Should fintechs choose an OCC limited charter or FDIC ILC charter?

With the recent approval of limited charters by the OCC, Broadridge's Ken Tays weighs the advantages and disadvantages of two types of charters available to today's fintechs.

Last July, the Office of Comptroller of the Currency (OCC) approved the issuance of limited charters to Fintechs, allowing them to lend and intermediate money transfers across the United States under one regulatory regime. Yet, to date, none have applied, likely because the Conference of State Bank Supervisors (COSBS) is challenging the OCC's legal authority to issue this type of limited charter. However, the OCC charter isn't the only choice. Fintechs could also explore the Federal Deposit Insurance Corporation's (FDIC) Industrial Loan Company (ILC) charter. Here are some differences.

The primary benefit of the OCC limited charter is that it provides the Fintech with a single regulatory framework for executing their business plan, whether that's lending or payment systems. This can greatly reduce compliance risk and associated costs. Currently, Fintechs are issued operating business licenses by the state in which they operate and must comply with the laws and regulations of that state or territory. That means they must understand and apply laws and regulations, and adjust their product and services, for multiple jurisdictions. The OCC limited charter reduces that burden.

Ken has over 30 years of work experience comprised of military and financial services. Ken began his career in the U.S. Army serving in Europe, Korea, and the United States and is a two-time combat veteran. Ken began his financial services career with the Office of Thrift Supervision (OTS) where he spent 12 years as a Senior Bank Regulator. Ken left OTS to join PricewaterhouseCoopers to work on Dodd-Frank implementation and regulatory issues around third-party oversight. Ken then accepted a position at Citi Bank in operational risk where he led the audit management, records management, supplier due diligence, data governance, and process and quality teams. Ken currently leads the governance, risk and control and internal audit practices at Broadridge Consulting Services, a division of Broadridge Financial Solutions, offering internal audit and GRC solutions to financial institutions.

A federal bank charter, however, will not allow Fintechs to obtain insured deposits. While they can compete with banks on loan pricing, they do not have access to lower cost funds provided through an FDIC insured deposit. They need to use higher cost funds or more capital, which reduces their interest margin if they do not offset the cost with higher loan rates and forces them to decide between profitability and competitiveness. A possible solution may be found in the ILC charter, which brings the advantage of access to insured deposits. Since it is issued by the FDIC, deposit insurance is naturally available, allowing Fintechs, especially lenders, to acquire inexpensive funds that increase interest margins and flow to the bottom line to increase profits.

WITH THE COST ISSUE ADDRESSED, JURISDICTIONAL REGULATORY AND COMPLIANCE ISSUES REMAIN.

ILC's have been around for over 100 years. They were created in the early 1900's, when the west was still "being won" and there were few banks in the region, to enable industrial companies to provide bank and bank-like services to their employees. While there is a proliferation of banks in the west today, the charter has survived. The FDIC placed a moratorium on issuance in 2008 due to the financial crisis, but it was lifted in 2013 and no charters have been issued since then. In fact, there are only 24 ILC's today and no charter has been issued in over a decade. Square, for example, applied for an ILC charter in 2018 only to rescind in July of that year and announce in December that they were revisiting the option. Seven other Fintechs have submitted and subsequently pulled applications for an ILC charter in recent years.

Any Fintech interested in obtaining a charter will need to evaluate the advantages and disadvantages of each model and questions still remain:

1. How and when will the COSBS lawsuit be resolved?

2. Will the FDIC allow Fintechs to obtain an ILC charter?

3. What will be the preferred charter?

4. Will Fintechs decide against charters all together?

Regardless of the answers, Fintechs are becoming a disruptive force in the banking sector, causing a high level of disintermediation. It will be interesting to see what part these charters will play in the new structure of the banking landscape.

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