

Tailored R&R – New and Important for Fintech Charters

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The [OCC's announcement](#) that it will begin accepting applications for nondeposit fintech charters is an important and welcome development, especially in light of the [Treasury's](#) explicit support for the nondeposit fintech charter and responsible innovation. The OCC described the fintech charter as allowing fintech companies to acquire or obtain a special purpose national bank (**SPNB**) charter under which the SPNB would be limited to engaging in “one or more of the core banking activities of paying checks or lending money, but would not take deposits and would not be insured by the [FDIC].” We assume most investors and business models looking at the nondeposit fintech charter are already well aware of its general advantages and limitations, as well as the basics of the [application process](#) and the risk of [a renewed suit](#) over whether the OCC has the authority under the National Bank Act to issue such SPNB charters.

- **New & Important Contingency Planning.** The OCC's requirement for recovery planning and, to some extent, resolution planning before final approval of an application is new and important. The planning requirement cannot be understood based solely on the four corners of the OCC's Fintech Supplement to its Licensing Manual – it must be cross-read against the OCC's [Recovery Planning Guidelines](#) for large banks and its [December 2016 rule](#) on receiverships for uninsured national banks, as well as the [Federal Reserve](#) and [FDIC's](#) resolution planning rules.^[1]
- **Tailored R&R.** Based on our experience advising larger banks on recovery and resolution, the OCC has clearly tailored these new recovery and resolution (**R&R**) requirements to fintech firms. The purpose seems to be that if these firms can show that they are safe to fail without causing the sort of contagion that could destabilize the financial system or induce the government to bail them out, then they should be free to engage in a more limited, less diversified set of banking activities than would ordinarily be permitted for a general purpose national bank. We nevertheless read these tailored R&R requirements

for fintech charter applicants as significantly more serious than for applicants seeking garden-variety national bank charters. The OCC's explicit reference to the Recovery Planning Guidelines for large national banks means that some of the formal requirements of recovery planning, such as triggers and governance frameworks, are also likely to be required of fintech charter applicants (as described below). The requirement to include options "for selling, merging, or liquidating the bank" are classic resolution plan techniques and beyond the scope of the Recovery Planning Guidelines, loathe as the OCC may be to say the word "resolution" out loud. But that higher level of seriousness should not mean that the heavy and lengthy recovery and resolution plans required for much larger banks become the pattern card for fintech startups. It will be critical that the OCC applications staff adhere to the principle in the Fintech Supplement that "[t]he format and content of the plan are flexible and should be tailored to the bank's specific business and reviewed and updated as the bank's business evolves." We believe that only some key elements of the normal R&R process should be in tailored R&R plans.

- **Recovery Planning Triggers.** The OCC's Recovery Planning Guidelines require recovery plans to include quantitative and qualitative triggers that reflect a bank's "particular vulnerabilities" across a continuum of increasingly severe stress, from early warnings to imminent doom. When a trigger is breached, decisions on whether to implement the recovery plan will be escalated to the bank's senior management or board. It is important to note that these recovery plans are war-game contingency scenarios. They are not binding on the bank, its investors or the OCC. Each recovery plan lays out a range of options that a bank could take to restore its financial strength in a stress scenario – such as raising capital or strategically selling assets or businesses – with information on how each option would be carried out and how its execution would impact the bank. Nonetheless, once an issue has been escalated, senior management or the board must reach an informed, well-documented decision even if they choose to stand fast. The art of trigger calibration therefore calls for balance between the need to escalate early enough that recovery options remain viable but not so early that they constrain business as usual and, in effect, become tantamount to excessive capital or liquidity requirements.
- **Recovery Planning Governance.** Banks must also integrate their recovery plans with their governance structures. In business as usual, a bank's recovery plan must be reviewed and updated by its management and approved by its

board at least annually. In contemplation of stress, recovery plans must outline the procedures for decision making in response to the breach of a trigger, describe the data and information that would be reported to management and the board, and identify the individuals and departments of the bank responsible for executing their decisions.

- **Contingency Sales or Merger.** These are not run-of-the-mill M&A transactions. The urgency of a stress scenario will narrow the universe of potential acquirers, curtail due diligence and raise other obstacles for firms that have not adequately prepared. Fortunately, the techniques for executing a transaction under such conditions have been refined for years in the resolution planning context. Fintech banks can leverage and adapt the tools and strategies that have become market standards among large banks in many areas – from playbooks and template pro formas, to methods of identifying and addressing the financial, operational and legal obstacles to an accelerated closing.
- **Timing of Plan Development.** The filing of a complete application begins the review phase, which the OCC – admirably, though perhaps aspirationally – will seek to complete within 120 days. Upon receiving a preliminary conditional approval, a fintech charter applicant must then develop its tailored R&R plan during the organization phase before it may open for business with a final approval.
- **Annual Update.** The plans must be annually reviewed and updated as needed thereafter. This requirement is in line with the cycle of filings for large bank recovery plans but out of step with the resolution planning process, which is moving to a two-year cycle.
- **Changes Require a Non-Objection.** Like a de novo business plan, significant changes require a non-objection from supervisors. This is a new and unusual requirement in the recovery and resolution planning process and we question how it will work in practice, especially once a fintech bank has fledged from de novo status. This requirement strikes us as one that ought to be reconsidered after there is practical experience with it.

[1] The OCC's final rule on receiverships for uninsured national banks is based upon the FDIC's receivership powers under the Federal Deposit Insurance Act, which laid the groundwork for the new requirement.