

Statement for the Record

on behalf of the

American Bankers Association

Before the

Subcommittee on Consumer Protection and Financial Institutions

April 15, 2021

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The American Bankers Association¹ appreciates the opportunity to submit a statement for the record for the hearing titled “Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters.” Recent activity at federal and state levels regarding granting novel charters should be subject to Congressional oversight to ensure the safety of consumers and the payment system itself.

As the only banking trade association representing banks of all sizes, ABA strongly supports and seeks to streamline de novo bank formation; supports and seeks to facilitate responsible bank innovation including new technologies, partnerships and business models; and believes in charter choice. We believe that our diverse banking ecosystem is a source of strength, and support new entrants and new ways of reaching consumers. However, we do not believe that jurisdictions should create new charters, or apply new interpretations to traditional charters, that are designed to pair bank-like benefits such as federal preemption and access to critical shared infrastructure like the Federal Reserve payment system, with less regulation and oversight of consumer and systemic risks.

New state charters focused on cryptocurrency business models and recent action at the OCC where applications for traditional charters are being considered and granted for non-traditional business models present novel risks to the payments system that we all rely upon to operate seamlessly. These new charters enable these entities to seek a bank charter without being subject to the same oversight and regulation as any other bank. This regulatory arbitrage risks creating a two-tiered system where these entities’ customers and counterparties will be subject to increased risk and weaker consumer protections.

The state of Wyoming has created a Special Purpose Depository Institution (SPDI) bank charter that allows entities to hold uninsured customer funds. These SPDIs may be called banks, but they will not be subject to consolidated supervision, under the Bank Holding Company Act (BHCA), will not have FDIC oversight, and may create new opportunities for fraud or money laundering. Further, as they take only uninsured deposits or no deposits at all, these SPDIs and

¹ The ABA is the voice of the nation’s \$18.7 trillion banking industry, which is comprised of small, midsized, regional and large financial institutions. Together, these institutions employ more than 2 million people, safeguard \$14.6 trillion in deposits and extend more than \$10.5 trillion in loans.

non-traditional OCC chartered banks will not be subject to the Community Reinvestment Act (CRA). SPDI's grant entities bank powers without the accompanying oversight.

In recent months, the OCC has embarked on its own mission to broaden the definition of entities eligible to apply for standard charters. While the payments charter debate, and the OCC's special purpose chartering authority more broadly, is pending legal action, this new approach would allow entities that previously would not have met OCC requirements for a charter to be considered and in some cases granted a charter. The two recently granted OCC trust charters to firms offering digital custody services were made possible by [OCC Interpretive Letter 1176](#)² (IL 1176) issued during the last week of the former Acting Comptroller's tenure and two days before the charter applications were provisionally approved. IL 1176, drafted without any public comment or input, lowered the standard for eligibility for the OCC trust charter by denoting that any entity that meets a lower state charter requirement now, by default, is eligible for an OCC charter. The OCC also considered an application for a standard charter from an entity that would hold uninsured deposits.

- The novel charters and novel application of traditional charters at the state level and the OCC have a common theme. By avoiding the requirements regarding taking insured deposits, both the state and the federal charter "innovations" allow the parties to avoid regulation as a "bank" for the purposes of the BHCA. The BHCA should be required and not optional for these applicants. We believe that specific steps should be taken to ensure that attempts to achieve regulatory arbitrage in Wyoming and at the OCC do not present increased risks to consumers and the payment system. The Federal Reserve should develop evaluation procedures that will be consistent across all of its districts to evaluate the risk these novel charters and novel businesses with traditional charters will pose to the payment system. This policy should be developed in an open and transparent manner with public comment to ensure that all parties involved are able to participate. Access to the Federal Reserve payment system is a privilege and not a right
- Congress and the OCC should conduct a thorough review of OCC activities related to the publication of IL 1176 including the timing of its release and the decision to bypass the standard practice of a formal notice and comment period. Additionally, the OCC should provide its justification for considering granting entities holding uninsured deposits national bank charters.
- The OCC and states should not grant charters to banks that take deposits but are structured to avoid BHCA oversight.

² OCC Interpretive Letter 1176, January 11, 2021, <https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1176.pdf>

Special Purpose Depository Institutions (SPDIs)

In 2019, Wyoming created a new type of bank charter targeting cryptocurrency businesses. The entities recently chartered in Wyoming, Kraken Financial and Avanti Bank & Trust, are cryptocurrency-focused firms that have obtained state charters for the express purpose of, among other things, connecting directly to the payment system. We believe that the nature of the businesses engaged in by these entities presents heightened risks that should be taken into consideration before the Federal Reserve grants such access.

Kraken Financial's business model is unusual for state-chartered institutions and for depository institutions generally in that (1) its principal business is to provide a banking gateway between digital assets and national currencies (a business that raises heightened anti-money laundering, Bank Secrecy Act and terrorist financing concerns and is subject to high volatility³); and (2) it presents potential risk to the payment system and other risks without appropriate supervision across the breadth of its affiliated entities.

Avanti Bank and Trust plans to offer digital asset custody services and to act as a "bridge" to the U.S. payment systems. As part of its business model, it will create and issue Avit, a tokenized equivalent of the U.S. dollar to enable institutions to settle transactions in real time.

Under Wyoming's SPDI Charter, any deposits at these institutions must be 100 percent backed by reserves. Neither of these institutions will be required to have FDIC insurance or be subject to FDIC oversight. State law also prohibits SPDIs from making loans funded by customer deposits.

The lack of FDIC insurance and commercial loan offerings suggests that SPDIs would not meet the definition of a "bank" under the Bank Holding Company Act (BHCA). This means that related entities would not be subject to consolidated supervision by the Federal Reserve. This is a significant concern because, for example, Kraken Financial's parent company operates a large cryptocurrency exchange with an associated risk level that is unknown.

Another issue that is concerning is the lack of insight into how these entities will be examined. The Wyoming Banking Commission is the sole oversight body and it granted the charters before the examination guidelines were complete. It is troubling that a charter was issued without evidencing publicly an ability to evaluate the applicants' ability to meet requirements that had yet to be created.

Importantly, interest in these SPDI charters is growing within Wyoming and beyond, and the Federal Reserve is likely to face questions about access in multiple Districts. Specifically, proponents of the Wyoming approach are pressing for similar models in several states which could help facilitate adoption across the country. If they follow Wyoming's model there will be no federal oversight of these novel state charters.

Our banking system is enriched by new entrants, new technology, and new business models, but its strength and resiliency are derived from the assurance that every financial institution adheres to common regulatory standards and supervisory scrutiny. Applications for master accounts and

³ Report of the Attorney General's Cyber Digital Task Force Cryptocurrency Enforcement Framework, October 1, 2020, <https://www.justice.gov/ag/page/file/1326061/download>

direct access to the payment system from state-chartered SPDI novel and heightened risks that merit thoughtful consideration. More information is needed from these and future applicants to enable the Federal Reserve Banks to evaluate the risks of their direct access to the payment system.

We urge the Federal Reserve Board to delay granting non-traditional entities like these access to master accounts or Reserve Bank payments services until it has adopted, in a transparent manner after notice and comment, a uniform policy that would apply to the Federal Reserve Banks exercise of discretion when evaluating requests by non-traditional charter applicants for access to such services.

The OCC's Policy Shift Enabled by Interpretative Letter 1176

The OCC made significant policy changes regarding the eligibility requirements to receive a trust charter through IL 1176 without public input during the final days of the previous administration. That change has already, and will continue to facilitate, charter approvals that we believe are ill considered. We oppose the circumstances under which these applications are being submitted, evaluated, and even conditionally approved.

It seems that this process began in the summer of 2020 when Former Acting Comptroller Brooks made clear his belief that payments companies that neither take deposits nor make loans are eligible for a national bank charter. Shortly thereafter, a number of firms, particularly cryptocurrency-related firms, began applying for national bank and trust charters. The charter related activity concluded with a frenzy of activity during the final days of Comptroller Brooks' days at the OCC. The following timeline illustrates the activities.

On Friday, January 8th, 2021, a group of trade associations outlined concerns to the OCC in a [comment letter](#) on two pending applications for an OCC trust charter. The letter noted that the applicants' business models do not involve the types of fiduciary activities performed by national trust charter banks. In short, the Associations believe that providing custodial services for digital assets is not a fiduciary activity and that granting charters where traditional fiduciary activity is absent would represent a significant change in OCC policy that should be made only with proper public notice and comment period.

On Monday, January 11th, 2021, the OCC published [Interpretive Letter 1176](#), OCC Chief Counsel's Interpretation on National Trust Banks that expanded the scope of entities eligible to apply for a national trust charter. The new interpretation effectively eliminated the longstanding requirement that applicants for national bank trust charters engage in fiduciary activities. This significant change in OCC policy was made with no public comment and review.

On Wednesday, January 13th, 2021, the OCC granted conditional approval to Anchorage Digital Bank (Anchorage) on the basis that its activities, primarily providing custodial services for digital assets, meets the requirements to receive a South Dakota state trust charter and under the new Interpretive Letter 1176, is eligible for a national trust charter.

A second state trust charter conversion to an OCC trust charter was granted on February 4th to Protego Trust Bank (Protego) based in Washington state. In its press release, Protego stated its core business lines are custody of digital assets, a digital asset trading platform for client use, facilitating digital asset lending and borrowing amongst bank clients, and issuing new digital assets. Because this was a conversion to an OCC charter there was no public comment period and information regarding its business model is limited. Like Anchorage, it appears Protego would not have been eligible for an OCC trust charter without Interpretive Letter 1176.

On Thursday, January 14, 2021, Acting Comptroller Brooks resigned.

On Wednesday January 20, 2021, all Executive Agencies received the Memo calling for a review of all pending rules and regulatory interpretations. The Interpretive Letter, as an “agency statement of general applicability and future effect that sets forth a policy on a statutory, regulatory, or technical issue or an interpretation of a statutory or regulatory issue” is precisely the type of agency action that the memo was intended to address. In the spirit of the memo’s intent, we asked that Interpretive Letter 1176 be withdrawn and that any changes in the OCC’s eligibility requirements for a national trust or national bank charter be subject to a conventional rulemaking process, with public notice and comment. This significant policy change deserves thorough and transparent analysis by all interested stakeholders.

The OCC responded that it is an independent agency and not bound by the Memo.

As noted earlier, we believe that IL 1176 should be recalled and the entire issue should be subject to a typical public notice and comment period. This is a significant policy change that is due an open and transparent review by the OCC and the public that it affects. Instead of a flurry of activity behind closed doors during the closing week of an administration this issue deserves deliberate considerations.

The OCC’s Consideration of the Figure Bank National Bank Charter Application

We also believe that Congress and the public would benefit from learning more about the OCC’s review of a recent application for a traditional charter by Figure Bank, a non-traditional entity. Although we support the OCC’s many initiatives to facilitate financial innovation, the OCC must ensure that appropriate regulations apply consistently to all national bank charters and that no regulatory gaps emerge. In the case of Figure Bank, that threshold has not been met.

This is an application for a traditional OCC national bank charter by an entity that will not take insured deposits. Figure Bank would have a significantly different risk profile from a traditional bank and would also be subject to a very different set of regulations, given that many banking laws are triggered by insured deposit taking. This new bank would not be subject to FDIC oversight through the Federal Deposit Insurance Act (FDIA) or consolidated supervision by the Federal Reserve under the BHCA). Importantly, it will also not have any obligations under the Community Reinvestment Act (CRA). This non-traditional application for a traditional national

bank charter is like inserting a square peg into a rectangular hole. It may fit if enough force is used, but that is not the way bank charters should be granted.

There is also significant uncertainty about the OCC's authority to issue charters to institutions such as these. Recently, the OCC proposed the creation of a special purpose bank charter to serve non-depository. That effort is currently being litigated in the Second Circuit. The New York Division of Financial Services (NYDFS) successfully challenged the OCC's authority to issue non-depository special purpose charters, and that case is currently under appeal.

The OCC must work carefully and cooperatively with the other banking agencies before any non-traditional bank charter is approved to prevent regulatory arbitrage that could undermine the safety and soundness of the national banking system as a whole.

For example, the Figure Bank application suggests that it will not be subject to consolidated supervision under the BHCA. Under the BHCA definition, a bank must either (i) have FDIC insurance or (ii) both accept demand deposits and make commercial loans. Although Figure Bank is applying for a national bank charter, its application actually resembles a special purpose bank charter application in that it would not take insured deposits and, therefore, would not have FDIC insurance or meet the definition of a bank under the BHCA. While limited purpose charters in the past have a specific exemption from "bank" status under the BHCA including trust charters and credit card banks, no such specific exemption exists for this standard national bank charter under consideration by the OCC, and the Federal Reserve Board has not yet publicized its views on the potential application of the BHCA to such a charter.

Through its authority under the BHCA, the Federal Reserve Board serves an important role in supervising banking organizations on a consolidated basis (i.e., banks together with their owners and affiliates). Importantly, the BHCA reflects Congress's policy determinations regarding oversight and supervision of holding companies that engage in activities beyond the bank subsidiary. Any change to this balance would represent a significant policy change. We believe that such a significant policy change should be subject to scrutiny through a robust, open, and transparent process in accordance with the Administrative Procedure Act public notice and comment process.

More information is needed regarding the Figure Pay product noted in the application. Figure Bank's application states that it will not take insured deposits, but it will offer "Figure Pay Deposit Accounts" to consumers. These accounts will accept ACH transactions and be linked to debit cards. The application provides no explanation on how Figure Pay will connect to the payment system. If it is through a financial institution, that institution should be identified.

A non-depository national bank charter raises significant consumer protection concerns and may create reputational risk for all banks.

Conclusion

The OCC should proceed with great care in its consideration of non-traditional applicants for national bank charters to ensure that it does not undermine the value of traditional charters by holding new applicants to less stringent standards.

A bank charter is a clear signal to customers that they are dealing with a trusted partner. The title “bank” carries significant weight in the mind of customers. Any company granted a national bank charter will receive the instant credibility that comes with being a bank. Likewise, any missteps by a company operating through a national bank charter will inevitably reflect on all banks. This is why a patient and careful process is required that ensures all key issues are fully addressed.

The OCC must exercise its powers carefully and be certain that all applicants for national bank charters meet and are held to the highest standards to protect consumers and the industry itself.

A bank charter is not something to be taken lightly. The seal of approval conferred by the OCC when it charters a national bank is an important marker of trust to customers. Based on the different level regulatory oversight that will be applied to Figure Bank because it does not take deposits than would apply to banks holding the same charter, we oppose the OCC granting a national bank charter to this applicant.

Thank you for the opportunity to submit this Statement for the Record.