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When you reach the end of your rope, tie a knot in it and hang on.

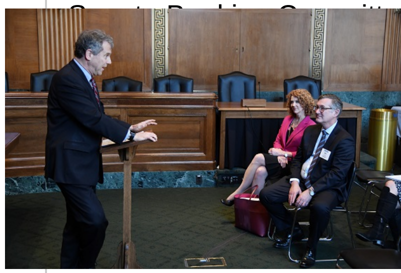
- Franklin Delano Roosevelt, who passed this day in 1945

State Regulators Go to Washington

By John Ryan

CSBS President and CEO

Last week, CSBS hosted 75 regulators from 42 states at our 2019 Government Relations Fly-In.



and CEO John Ryan
at the CSBS 2019
Government Relations Fly-In

Over the course of several days, we met with leaders at the Federal Reserve Board of Governors and FDIC, as well as leadership of key financial services committees in the House and Senate.

These fly-ins are important. They give us an opportunity to share our top priorities with policy makers, especially the following:

Ensuring a simplified capital framework for community banks: We are concerned that as proposed, the community bank leverage ratio (CBLR) will not provide the relief intended by S. 2155. By proposing an alternative prompt corrective action framework, the agencies are raising capital standards. Last week was a critical opportunity to continue to express our views to the agencies as well as highlight this issue with members of Congress.

Appointing an FDIC board member with state bank supervisory experience: We want an individual with state bank supervisory experience to be named to the FDIC board, as required by federal law. There are two current vacancies on the board, making this a perfect opportunity. In addition to being federal law, a director with state bank supervisory experience expands the FDIC board’s knowledge base to include a practitioner with direct experience of the approximately 4,400 state-chartered banks that make up 79% of the nation’s banking system. That is important, as the FDIC coordinates with the states to examine most of these banks.

Promoting Vision 2020: The initiatives to modernize and harmonize nonbank state supervision are extremely important to CSBS and our members. We want a system that serves local needs but works efficiently. Last month we announced our next steps to create uniform definitions and practices, increase transparency and expand the use of common technology based on recommendations from our Fintech Industry Advisory Panel. We have a number of other initiatives underway that are intended to increase transparency, improve communication and enhance technology and automation. The appreciation and understanding of these initiatives by policy makers are critical to their success.

Supporting Community Banks and Innovation: This is an important part of Vision 2020. Banks, particularly community banks, rely on outside vendors for a variety of services and look to leverage technology partners. We developed federal legislation (H.R. 241) to amend the Bank Service Company Act to enable state and federal regulators to better coordinate supervision of bank vendors. As currently written, the law effectively impedes coordinated state-federal third-party service provider supervision. We want to build on the momentum from the last Congress, when the House Financial Services Committee approved a similar bill by a vote of 56-0, drawing supportive statements from senior Republicans and Democrats.

As I said, these fly ins are important. They give state regulators the opportunity to raise the policy issues that are important to us from a local perspective. Members of Congress appreciate the opportunity to hear from the officials from their states. Additionally, building productive relationships with federal counterparts helps ensure safety and soundness, protect consumers and economic growth and foster innovative, responsive supervision.

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OCC Fintech Charter Undermines Important State Consumer Protections

Last year, the Office of the Comptroller of the Currency (OCC) announced its decision to accept applications for special purpose national bank charters from nonbank fintech companies (fintech charters) that do not and would not engage in receiving deposits or be insured by the Federal Deposit Insurance Corp. Since that time, the OCC has defended this decision as good for America’s dual banking system and good for American consumers because it enables nonbank fintech companies to choose to “apply for federal charters” and “operate nationwide.”

This claim raises some important questions: What is a bank charter for? What does operating nationwide really entail?

In answering these questions, put yourself in the place of a financial services start-up. You, the start-up, have developed an innovative financial service and you want to start a business to offer this service. Do you need to apply for a bank charter and become a bank?

Answer: Only if you intend to engage in deposit-taking. This is because obtaining a bank charter is legally required only to engage in the activity of deposit-taking. All other activities conducted by banks—whether lending activities, payments activities or other financial activities—can be conducted by individuals without obtaining a bank charter.

Well, if applying for and obtaining a bank charter is required only to engage in deposit-taking, then why would the OCC create a charter for businesses that do not and would not engage in deposit-taking?

Answer: To facilitate nationwide operation by preempting state law. Although a great deal of financial services can be conducted without obtaining a bank charter, unlike banks, nonbank financial companies must comply with state usury laws, state licensing requirements and other state consumer protection laws in each and every state in which they operate. National banks, on the other hand, are not subject to these state law restrictions due to something called “preemption.” Escaping state consumer protection law via preemption is the only reason that the OCC is offering, and nonbanks are seeking, the fintech charter. They do not desire to become banks; they simply want the preemption afforded banks.

But the extension of national bank preemption to nonbank financial companies is an unprecedented move that is, and should be, incredibly concerning to American consumers and policymakers. To understand the significance of the OCC’s actions, we need only examine three types of state law restrictions from which nonbank fintech companies desire to escape: state usury laws; state licensing laws and state fair lending and anti-discrimination laws.

State Usury Laws

State usury laws cap the interest rates and finance charges that a business can charge in lending money. Different states have set these interest rate caps at different levels in balancing the competing policy priorities of credit access and credit affordability. Federal law, however, preempts the application of state usury laws to banks in two main ways.

First, unlike nonbanks, banks are permitted to “export” interest rates interstate. This means that a bank is allowed to apply the maximum permissible rate in any state in which the bank is located to loans to customers residing in a different state, even if the rate exceeds the highest permissible rate in the state in which the borrower resides. In addition to interest rate exportation, under what is called the "most favored lender" doctrine, banks are permitted to loan at the highest rate permitted to any lender in the state—so, for example, if a state places a higher interest rate cap or no interest rate cap on loans made by certain institutions and places a lower interest rate cap on banks, then a bank may lend at the higher interest rate (if there is a cap) or any interest rate (if there is no cap). So, in extending the preemption of state usury laws afforded banks to nonbanks, the OCC is permitting nonbanks, for the first time in American history, to override state usury laws and engage in what would otherwise be usurious lending.

Congress has not extended the privileges of interest rate exportation and the most favored lender doctrine to nonbanks because the issues of credit availability and affordability are matters of local concern, which take on a different complexion in different areas of the country facing different economic circumstances. Striking the right balance between these competing policy priorities is simply not something that is amenable to a national, one-size-fits-all solution.

Additionally, if nonbanks are allowed to export interest rates, then consumers will no longer be able to exercise control through democratic processes over the cost of credit offered within their state. In recent years, democratic participation has enabled consumers to lower the interest rate caps in their states, even to the point of banning payday lending within their state. For example, in 2010, Arkansas citizens voted to pass a ballot initiative to amend their state constitution to establish a 17 % annual rate cap for consumer credit extended to Arkansas residents. This effectively banned payday lending in Arkansas. But if the OCC is to succeed in its project to extend interest rate exportation to nonbanks, then initiatives like those seen in Arkansas will be no more, for the Comptroller will have taken away the ability of consumers, as citizens, to play a role in setting policies that significantly impact their economic destiny.

State Licensing Laws

Every state has licensing laws that require nonbank financial services providers to obtain a license to offer financial services to residents within their state. These licensing laws cover activities such as money transmission, consumer lending, mortgage lending and debt collection. Through these laws, licensed nonbanks must adhere to restrictions on their business practices and restrictions on product terms. Under these laws, a state official is appointed to administer licensing processes and supervise licensees for compliance with state consumer protection laws. The state official is generally appointed by an elected official and thereby is accountable to state citizens for how he or she implements state consumer protection laws.

The OCC has asserted nonbanks that receive the fintech charter will not be subject to state licensing and oversight because state licensing laws would be preempted. In so doing, however, the Comptroller breaks the chain of accountability between regulator and consumer. Consider a situation where a fintech charter recipient arguably violates a non-preempted state consumer protection law and the OCC fails to apply and enforce that law. Suppose a state resident or legislator disagrees with how this law is interpreted or enforced. What mechanism is in place for this person to remedy the situation by compelling a more proper interpretation? Even if theoretically some amendment to the law could be made towards this end, what mechanism is in place to hold the OCC accountable for its interpretation? In every case, the answer is none.

This is why state consumer protection laws are administered and enforced by state officials, namely because the latter are appointed by and directly accountable not only to the individuals who write state consumer protection laws but also the consumers of the financial services subject to those laws. While the OCC may tout its "local presence," it is present in only a geographic sense, which is a poor substitute for the direct political accountability inherent in the official positions of state regulators. Indeed, the wisdom in imbuing financial regulation in the United States with our federalist system of government is, as the Supreme Court has stated, that it enables states "to respond, through the enactment of positive law, to the initiative of those who seek a voice in shaping the destiny of their own times, without having to rely solely upon the political processes that control a remote central power."

State Fair Lending and Anti-Discrimination Laws

Not to worry, the OCC says, because state anti-discrimination laws and fair lending laws would purportedly apply to these national nonbanks. We have heard this line before in the years leading up to the financial crisis when the OCC, among other things, extended national bank preemption to nonbank subsidiaries of national banks. In reversing this action through the passage of the Dodd-Frank Act, Congress describedthe OCC's preemption campaign of the early 2000s as actively creating an environment where abusive mortgage lending could flourish without state controls in an effort to attract additional charters.

Nevertheless, here we are again faced with the OCC's assertion that it applies state anti-discrimination and fair lending laws to national banks. The fact is the OCC had ample opportunity, in implementing the Dodd-Frank Act changes to its preemption regulations in 2011, to include anti-discrimination and fair lending laws among the list of laws not preempted. But it refused to do so. The omission of any reference to these laws should cast some doubt on the claim that these laws actually would be applied.

In any event, when the OCC says fair lending and anti-discrimination laws would continue to apply, it must be remembered that these laws would only apply to the extent that the OCC feels like applying them. Unlike a state regulator, the OCC is not directly accountable to state legislators for not applying these laws, and, because state oversight is preempted, state regulators cannot check or fill the regulatory void left by the OCC's non-enforcement of the laws. These are the reasons that the OCC's historical track-record in actually applying these laws is so abysmal. Anyone who thinks that this dynamic would now change by the OCC taking the unprecedented action of creating a nonbank charter is fooling themselves.

Conclusion

National bank preemption has a storied past, one with which states and Congress are, regrettably, all too familiar. So, when the OCC seeks to downplay the significance or unprecedented nature of extending preemption to nonbanks through the fintech charter, we should not forget the OCC's role in using preemption to lay the legal foundation for the financial crisis. And when the OCC or others laud the fintech charter as expanding choices for consumers, we should ask ourselves whether the OCC overriding state consumer protection laws enacted at the behest of these consumers is really enabling choices that these consumers want.

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Capital Simplification Proposal Needs Tweaks to Provide Real Regulatory Relief

A proposed new interagency rule intended to provide regulatory relief to community banks has too many obstacles to be effective; however, a few modifications would provide these smaller banks with the capital simplification intended by Congress, CSBS said in a comment letter to the OCC, Federal Reserve and FDIC this week.

Last spring, Congress directed the federal agencies to develop a community bank leverage ratio (CBLR) in Section 201 of the Economic Growth Regulatory Relief and Consumer Protection Act. The goal is to provide qualifying community banks relief from the complexities and burdens of the current risk-based capital rules while ensuring that they maintain a high quality and quantity of capital consistent with requirements of the current rules.

However, several provisions in the CBLR proposed by the federal agencies would discourage community banks from opting to use it. Through the public comment process, state regulators are hoping to ensure the proposed CBLR provides the intended regulatory relief – not regulatory burdens.

In an earlier comment letter sent to the federal agencies in February, CSBS recommended eliminating the proposed new prompt corrective action (PCA) framework for banks that use the new CBLR. CSBS suggested the CBLR should use the current Tier 1 leverage ratio rather than creating a new capital measure, which would allow a community bank that falls below the CBLR to more easily begin reporting capital ratios under the current risk-based capital rules.

In this week’s letter, CSBS recommended additional changes to the CBLR to expand eligibility, lessen complexity and ensure that state regulators are involved, as Congress intended:

- The rule should provide a limited grace period to allow community banks to either come back into compliance with the CBLR or return to complying with the current risk-based capital rules.

- The CBLR should not include qualifying criteria for concentrations in mortgage servicing assets or deferred tax assets. These criteria are not necessary if the CBLR is a Tier 1 leverage ratio.

- The definition of “off-balance sheet exposures” in the qualifying criteria is overly broad and adds complexities rather than reduce burdens.

- The proposed rule should include language requiring federal agencies to notify state bank regulators when a community banks has opted out of the CBLR framework between reporting periods to fully meet the law’s requirements.

- The proposed rule should provide for state bank supervisors to be at least consulted by the FDIC or Federal Reserve in their discretionary decisions relating to community banks qualifying for the

CBLR.

Last week, Federal Reserve Governor Michelle Bowman pledged to re-engage with state regulators on the matter.

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Video: Community Banks and Relationship Lending

Every year, CSBS conducts a nationwide survey of community banks. The video below highlights findings on how community banks engage in relationship lending.

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