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SPNB Charters for FinTech Companies: A Primer

The number of tech companies offering alternatives to traditional banks has increased severalfold in recent years, piquing the attention of state and federal regulators. For FinTech companies engaged in certain aspects of the “business of banking,” a special purpose national bank (SPNB) charter may be one avenue for ensuring continued compliance with applicable regulations.

“FinTech,” short for financial technology, is currently a popular buzzword and catch-all term encompassing the following: (1) the activities of financial companies that use technology to provide financial services like online checking or check truncation (depositing checks via a scan or photo electronically transmitted to the bank, rather than a physical transfer of paper checks);^[1] or, conversely, (2) non-financial tech companies that have decided to market a financial product or service, such as a budgeting app or a payment (fund transfer) mechanism using only your smartphone.^[2]

In the first type of FinTech, the business should already have an appropriate charter permitting the provision of financial products and services. As such, FinTech represents a new way to provide the same service, historically analogous to the movement from live tellers, to automated teller machines at branch offices where your deposit stayed in the branch building, to bank-owned automated teller machines offsite where information is transferred electronically to the bank. In this situation, there is no need for a new bank charter. Rather, the primary regulatory reaction to a FinTech innovation is to ensure that the new method for delivering a product or service complies with applicable law (e.g., nondiscrimination and data security) and that it does not endanger the chartered institution’s safety and soundness (e.g., fraud and theft).

The purpose of this blog post is to provide an overview on how and why the second type of FinTech companies might use a special purpose national bank (SPNB) charter to offer financial industry-related business products and services.

Not all FinTech products and services require a bank charter. This requirement is dependent on if the product or service is “the business of banking.” The scope of what is “banking” is beyond this post. But, for an idea of what is “banking,” see *NationsBank of North Carolina, N.A. v. Variable Annuity Life Insurance Co., and Ludwig, Comptroller of the Currency*, 513 U.S. 251 (1995), which discusses whether offering variable annuities is “the business of banking” under 12 U.S.C. Section 24. More relevant here is the question of whether a non-financial services company needs to obtain a state or federal bank charter to legally offer the planned financial products and services. For example, in the *NationsBank of North Carolina* case, the United States Supreme Court agreed with the Office of the Comptroller of the Currency (OCC) that an annuity resembles a savings account in that it represents deferral of the enjoyment of money. As such, the Court allowed that a national bank’s subsidiary may be authorized to sell annuities.

National banks are regulated by the federal government, and the OCC is the agency tasked with overseeing and enforcing some applicable regulations^[3]. The OCC issues federal “national bank” charters to entities that offer bank products and services in the U.S. Separately, banks can be chartered as state banks, making them subject to a combination of state and federal regulation. The classic distinctions between state and federal banks are as follows: (1) the chartering government examines the bank for “safety and soundness”; (2) federally chartered banks are exempt from certain state laws; and (3) the organizations that offer insurance to depositors are usually national in scope^[4] and cover both state and federally chartered financial institutions.

We all are familiar with the traditional full service “banks” that must be chartered as such: they accept deposits, make loans, and provide opportunities for customers to transfer funds to others via check, debit card, etc.^[5] In recent years, however, technology companies have begun to offer some but not all the services provided by a traditional bank; for example, certain FinTech “banks” may offer loans as its sole financial industry line of business, and some of these businesses may choose to be chartered by the federal government as a SPNB. In this context, “special purpose” means limited in the sense that not all banking products and

services will be offered by the SPNB chartered institution.

Generally speaking, SPNBs are subject to the same laws and regulations as traditional national banks, such as lending limits, the Bank Secrecy Act, and limits on real estate holdings, to the extent that those laws apply to the particular SPNB's activities. SPNBs also receive the same protections as traditional national banks, including limits on regulation and examination by states and preemption protection against the enforcement of certain non-federal laws and regulations (the classic preempted laws are certain state usury statutes).

On July 31, 2018, the OCC issued a statement detailing under what conditions it will consider applications for SPNB charters from FinTech companies that are engaged in certain aspects of the business of banking. On the same day, the Treasury Department released recommendations for facilitating financial innovation. *Inter alia*, the Treasury urged the OCC to approve SPNB charters while urging that any SPNB chartered FinTech companies not be permitted to accept deposits unless those new entities have full bank charters.

Separately, the OCC issued "Exploring Special Purpose National Bank Charters for Fintech Companies" as a supplement to the regular OCC document commonly known as the Comptroller's Licensing Manual; that supplement is available [here](#). This guide is a valuable reference for those considering application for a SPNB charter. At its essence, the OCC's guidance permits tech companies to explore how closely a SPNB charter will force their operation to resemble a traditional national bank. With that information, companies can weigh the benefits of the SPNB charter against the changes and regulations that will impact tech company's existing operations, organization and culture – a dichotomy we see often because banks must be operated and organized to meet regulatory obligations that do not apply to other businesses.^[6]

The OCC's publications are general in wording and applicability. So, any entity engaging in the "business of banking" under 12 U.S.C. Section 24 (Seventh) might apply for a SPNB charter. The OCC anticipates that FinTech companies are likely to seek SPNB charters

because of the prestige of a federal charter, the potential for nationwide growth facilitated by a federal charter, and the widespread harmonization of internet and technology-based products and services – including short-term consumer lenders; mortgage lenders and servicers; student loan lenders and servicers; wealth management and investing; and digital currencies and distributed ledger technologies (viz., blockchains).

The OCC and Treasury Department have both indicated that they expect to apply the same strict national bank charter standards to applications for, and operation of, a SPNB.^[7] For applications, that means the examination of a business plan, review of the marketing plan for compliance with nondiscrimination rules, evidence of adequate capital, etc. For operations, the level of federal involvement will depend on what financial services are being offered – for example, there is no need for examination by an insurer (such as the FDIC) if deposits are not being taken, but there may be a need for reporting on compliance with consumer protection laws if loans are offered to, and collected from, individuals.

The OCC's chartering plan for FinTech companies has not been universally applauded. Certain states worry about their own regulatory authority, and [two lawsuits were filed by states](#) before the first SPNB charter was issued to a FinTech company. Those suits were dismissed as premature but may be refiled after SPNB charters are issued and FinTech companies begin operation in the states that have expressed reservations about FinTech using SPNB charters.

Lawyers have long helped their business clients choose the appropriate operating entity (corporation or LLC or partnership, etc.) Lawyers also help their clients with regulatory compliance and licensing. The opportunity for a FinTech business to use an SPNB charter to offer a banking service or product is an extension of this proud history of facilitating our clients' successful businesses, and it warrants careful consideration.

For guidance on the evolving regulatory regime for FinTech businesses, particularly SPNB classifications, contact Frost Brown Todd attorney [Vince Mauer](#) (vmauer@fbtlaw.com). In addition to representing financial institutions for over 30 years, Vince is a

certified public accountant (CPA) with a master's degree in business administration.

[1] Such as Zelle, a person-to-person fund transfer app for smart phones from a group of banks.

[2] Such as Apple Pay or Google Pay.

[3] Other federal bank regulators include the FDIC and the Treasury Department.

[4] See the 1985 history lesson from the failure of Home State Savings Bank, an Ohio based state chartered financial institution. Home State's failure in 1985 led to a bank holiday for many other savings institutions that were also insured by the Ohio Deposit Guarantee Fund, a private entity.

[5] Other regulated businesses may provide similar "bank" services, think credit unions. These businesses have separate but similar regulation schemes like the National Credit Union Administration which charters national credit unions and operates an FDIC like insurance program for credit unions.

[6] For example, a SPNB would be organized under the National Bank Act and subject to rules arising thereunder including corporate governance, directors and classes of shares.

[7] The National Association of Federally Insured Credit Unions has issued a statement supporting the OCC's issuance of SPNB charters to FinTech companies. A November 8, 2018 statement includes this: "NAFCU acknowledges that fintech can produce real benefits to consumers, including increased speed, convenience and new product offerings that make it easier for them to manage their financial lives. However, the association has [urged lawmakers](#) and regulators to ensure a level playing field between fintech companies and financial institutions, from data security to consumer protection."

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