



SPNB Charters for FinTech Companies Will Impact Your Litigation Work

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Experienced counsel who regularly litigate for or against federally chartered and regulated financial institutions appreciate the differences that apply when a federally chartered and regulated financial institution is the plaintiff or defendant. All businesses maintain books and records needed to operate the business and meet the universally applicable reporting obligations (taxes and perhaps audited financial statements). Federally chartered and regulated financial institutions also retain records required to meet regulators' requirements of all types including safety and soundness, specific nondiscrimination rules^[1], etc. The existence of these additional documents impacts both sides of the document production work (requesting and producing).

^[1] See, for example, the Community Reinvestment Act (12 U.S.C. Section 2901 *et seq.*) and laws against redlining. Unique information must be acquired, manipulated and retained to meet these financial industry-specific rules.

Similarly, federal regulations mean that your client has employees who necessarily gather and work with information that other businesses do not have to collect and manipulate. The existence of these employees, some of whose job titles include the word "compliance," must be considered when you answer interrogatories about employees with knowledge and prepare (or respond to) a corporate representative deposition demand under FRCP 30(b)(6).

Federally chartered and regulated financial institutions must comply with special rules regarding information privacy and operate under special rules regarding subpoenas. See, for example, United States Code Title 12 ("Banks and Banking"). Chapter 35 ("Right to Financial Privacy") starting at 12 U.S.C. Section 3401. Moreover, these institutions have certain discovery privileges that are not generally available. See, *In re Bankers Trust Company*, 61 F.3rd 465 (6th Cir. 1995) and cases citing this decision for a discussion of the

privileges protecting documents generated by and for federal financial regulators.

The special considerations that impact litigation involving federally chartered and regulated financial institutions are about to expand in application and reach thanks to the emergence of FinTech.

“FinTech” is a currently popular buzzword short for “Financial Technology” and is used as a catch-all term for:

- 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 physically transferring the paper check to the bank).^[1] The above-mentioned special litigation considerations already apply to these financial institutions and that does not change just because those institutions are now active in FinTech^[2]; or, the reverse
- 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.^[3] These companies were not previously subject to special litigation considerations applicable to federally chartered and regulated financial institutions.^[4]

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, 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 Special Purpose National Bank (“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.

The Office of the Comptroller of the Currency (“OCC”) is a federal regulator of National Banks chartered in the USA.^[6] The OCC issues

federal “national bank” charters to entities that offer bank products and services in the USA. National banks are subject to regulation by the federal government.

Separately, banks can be chartered as state banks and then subject to a combination of state and federal regulation. The classic distinctions between state and federal banks are (i) that the chartering government examines the bank for “safety and soundness,” (ii) federally chartered banks are exempt from certain state laws, and (iii) the organizations that offer insurance to depositors are usually national in scope^[7] and cover both state and federally chartered financial institutions.^[8] It should be noted that all the above-mentioned special rules that apply to financial institutions are federal rules whose application to state chartered financial institutions varies.^[9] The point is not that litigation considerations should drive a FinTech company’s decision to seek a SPNB charter – rather, litigators are charged with knowing what laws apply to your client and case and the applicability of litigation rules specific to federally chartered and regulated financial institutions is expanding.^[10]

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). Litigators who represent tech companies that begin to offer financial services and products using a SPNB charter need to know that your client will now be subject to, and exempt from, certain laws that impact your client’s operation and your litigation work.

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. Further, 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. These entities can be expected to force SPNBs to meet certain regulatory obligations which means that litigators who represent tech companies will discover that their clients now have documents, employees and activities that were not previously part of their client's operations.

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 found at

<https://www.occ.gov/topics/responsible-innovation/comments/special-purpose-national-bank-charters-for-fintech.pdf> The OCC's guidance permits tech companies to explore how closely a SPNB charter will force their operation to resemble the operations of a traditional national bank.^[11] The more a FinTech company using a SPNB charter is treated as a national bank, the more that FinTech company's counsel needs to know the special litigation concerns that apply to national banks.

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.^[12] 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 – this would mean that any litigation privilege related to FDIC examination documents does not apply to that particular SPNB FinTech company. Counsel needs to know what portions of the federal regulation scheme apply to your SPNB FinTech client so you can understand what special litigation concerns are applicable.

Litigators:

- Our corporate counsel colleagues help their business clients choose the appropriate operating entity (corporation or LLC or partnership, etc.) and with regulatory compliance and licensing;
- For some, that will mean applying for a SPNB charter; and
- The impact of FinTech and SPNB charters extends beyond our corporate counsel colleagues – litigators need to understand the impact of the licensing and regulator choices made by our clients.

Tech companies: if your financial business is best operated as a SPNB, consider the importance of counsel familiar with the special rules that apply to regulated financial institutions in addition to your regular counsel who is familiar with your technology activities.

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

[2] In the first type of FinTech, the business should already have a charter permitting the provision of financial products and services and so FinTech represents a new way to provide the same service, analogous to the movement from (a) live tellers, to (b) automated teller machines at branch offices where your deposit stayed in the branch building, to (c) 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).

[3] Such as Apple Pay or Google Pay.

[4] Not all FinTech products and services require a bank charter. It depends on if the product or service is “the business of banking.” The scope of what is “banking” is beyond this post. 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) discussing whether offering variable annuities is “the business of banking” under 12 U.S.C. Section 24 (seventh). In this case, the United States Supreme Court agreed with the OCC that an annuity resembles a savings account in that it represents deferral of the enjoyment of money and a national bank’s subsidiary may be authorized to sell annuities.

[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] Other federal bank regulators include the Federal Reserve and the FDIC. Certain federal regulators, such as the FDIC, may also regulate state-chartered banks.

[7] 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.

[8] The OCC’s chartering plan for FinTech companies is not universally applauded. Certain states worried about their own regulatory authority. See <https://www.blockchainandbanking.com/conference-of-state-bank-supervisors-sues-us-comptroller-over-non-bank-charter-rule>

[9] The *Bankers Trust Company* case includes, *inter alia*, a discussion of certain then existing FDIC regulations addressing privilege from discovery. FDIC regulations apply to insured institutions regardless of the chartering governmental authority.

[10] Many of the considerations discussed herein will apply if a FinTech company (i) requires a “bank” charter, (ii) can use a state

charter, and (iii) opts for a state charter rather than a SPNB charter.

[\[11\]](#) 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.

[\[12\]](#) 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 statements 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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