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Most De Novo Banks Will Be Formed by Payments and Fintech Companies

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In the future, most de novo banks in the United States will be formed by existing payments and nonbank fintech companies that provide financial services, or groups of players in those industries that want to form a payments or fintech company using a bank charter. A steady number of traditional de novo banks will continue to be formed to service specific communities or other definable markets, but a majority of new banks will not fit that mold. The reason is that the barriers to becoming a bank are getting lower, and the business case for remaining a nonbank financial services provider is weakening.

Among other things, payments and nonbank financial service providers will be driven to form banks due to the following factors:

- The regulatory benefit from not being a bank is lessening — while there have been, and will continue to be, beneficial efforts to synchronize and simplify the licensing regime applicable to nonbank financial service providers, the activities that require licenses are growing, state and federal regulators are increasing their jurisdiction, and the ongoing focus on consumer compliance by these companies is now here. This increased regulation of nonbank financial services providers narrows the regulatory gap between banks and nonbanks, and will increasingly lead nonbanks to determine that the most rational decision is to become a bank, because the regulatory load on nonbanks is not as light as it used to be.

- A nonbank's ability to fund its business with low-cost deposits is becoming more important — although costs of funds are low across the board, the costs of deposits are much lower and easier to come by than bank debt or equity funding. Nonbank financial services providers spend an inordinate amount of time trying to line up funding and give up hundreds of basis points in cost of funds. Other cheap funding from a frictionless subordinated debt market and government lending programs are also readily available to banks. The ability to take FDIC-guaranteed non-interest-bearing deposits and get access to other sources of bank borrowing will increasingly lead nonbanks to pursue a bank charter.

- Having control and gaining additional revenue is becoming more valuable — although a group of banks around the country are providing the bank-as-a-service needs of payments and nonbank financial services providers, at some point, these companies become too valuable or complex to rely on third parties to obtain wholesale banking services, resulting in an unsustainable revenue split. These payments and fintech companies increasingly want to control what they can do, and pocket more of the revenue from those activities.

You don’t need the questionable and controversial “fintech charter” or industrial loan charter to get into the banking business. If you are a payments or fintech company, and are considering forming a new bank, it is a waste of your time and money to pursue an Office of Comptroller of the Currency (OCC) fintech charter. There has never been one of those, and likely never will be. It is also probably a waste of your time to try to form an industrial loan bank. Those entities have always been controversial, because they enable a bank to be owned by an unregulated holding company, and this is not the way to go if you want to get a bank up and running in less than 12 months.

Instead, if you want to build a payments or fintech-focused bank, either from scratch or by converting your existing business into a bank, you need to form a regular national bank with the OCC, or a state bank with your state of choice and the FDIC.

The good news is that the OCC, FDIC, and state regulators are open for business, and ready and willing to help payments and fintech companies form new banks. The bank regulators understand payments and fintech business plans, allowing you to create a bank from scratch within a year, if you satisfy the formation requirements. The process is straightforward for the lawyers and consultants that regularly form banks and the regulators that approve them. The capital required is the product of a clear regulatory formula that experienced bank formation experts know. The expenses are lower than seeking an exotic charter or buying a small bank.

The 2018 Georgia De Novo Bank Accelerator Series remains the most comprehensive summary of key requirements for forming a new bank, including:

- Business plan: You must have a reasonable business plan aimed at meeting an identifiable need.

- Management: You must have experienced directors and executive management with good financial character and reputations, who are capable of operating the bank in a safe and sound manner in compliance with applicable laws.

- Capital: You must commit sufficient capital in light of your business plan

The key to transforming a payments or fintech company into a bank is to prepare a detailed business plan that describes a viable banking business, and then perform a gap analysis of what the company has today and will need in the future (in terms of management, capital, etc.) for that business plan to succeed. Before you file, you need to fill in that gap, or have an acceptable plan to fill in that gap over time after formation as the business develops. If the regulators are the ones that tell you about major gaps after you have filed, you will not be successful within a reasonable amount of time.

A word of caution — creativity isn’t necessarily a four-letter word in the de novo banking world, but it is rarely rewarded by regulators. Instead, you need to understand from a regulatory standpoint which parts of your plan are outside the norm, and figure out a way to better describe it or approach it so it is either in the box, or minimize the portions that are outside the box.

Brilliance is also great, but like applying for a new job, in de novo banking, prior experience is more important. It is very difficult to get a bank charter if the proposed CEO, CFO, and other key executives weren't in those seats before at a well-run bank. It is not impossible to bridge an experience gap with training, consultants, or temporary role players, but a viable, acceptable plan is critical.

You also need to understand that the background and financial character standards for de novo bank directors, executives, and principal shareholders are steep. Many successful business people achieve success with personal and business financial failures along the way. Frankly, those types of failures have probably contributed to later success. Unfortunately, the payment of personal or business debts for less than 100 cents on the dollar and bankruptcies can be showstoppers in banking, notwithstanding the extraordinary success that a proposed director, executive, or principal shareholder may have achieved.

Bottom line — many payments and fintech companies that provide financial services will seek to form de novo banks, and a roadmap exists to do that successfully and efficiently. We are here to help you navigate that road, and have done it dozens of times over many years, including five times since 2018.

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