The Honorable Stephen F. Lynch, Chairman
Task Force on Financial Technology
Committee on Financial Services
United States House of Representatives

The Honorable Tom Emmer, Ranking member
Task Force on Financial Technology
Committee on Financial Services
United States House of Representatives

September 29, 2020

Dear Chairman Lynch and Ranking Member Emmer,

The National Association of Industrial Bankers[1] and the Utah Bankers Association[2] appreciate the opportunity to submit this statement for the record to the Task Force on Financial Technology Committee on Financial Services. Hearing on "License to Bank: Examining the Legal Framework Governing Who Can Lend and Process Payments in the Fintech Age".

I. Introduction

We applaud the efforts of the Task Force members to investigate and research changing dynamics of financial services in America. It is important that Congress ensure that American businesses and families have access to credit, but with robust consumer protections.

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[1] First chartered in 1910, industrial banks operate under a number of titles – industrial banks, industrial loan banks, industrial loan corporations and thrift and loan companies. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the U.S. economy. NAIB members are chartered in California, Nevada and Utah.

[2] The Utah Bankers Association is the professional and trade association for Utah's commercial banks, savings banks and industrial banks. Established in 1908, the UBA serves, represents and advocates the interests of its members, enhancing their ability to be preeminent providers of financial services.

We are also grateful that Industrial Loan Corporations (ILCs) are included in the discussion for this hearing. The purpose of this statement is to provide key facts regarding ILCs for the Task Force to consider and to correct unfortunate and misleading assertions made by some witnesses during the hearing.

In this regard, we ask the Task Force to note the information we provide is based upon quantitative sources such as FDIC call reports, premier academic analysis and judgments of state regulators. We encourage the Task Force to review the statement submitted by the Utah Department of Financial Institutions. Furthermore, we recommend "A New Look at the Contribution and Performance of Industrial Loan Companies to the US Banking System" by James R. Barth and Yanfei Sun, Department of Finance, Auburn University, July 2017 (Link:Barth Report on Brokered Deposits)

II. ILCs are among the safest, strongest financial institutions in the nation

For decades, FDIC call reports have consistently confirmed ILCs are well capitalized, safe and strong. This FDIC data shows that in comparison to commercial banks, ILCs are better capitalized, have a higher return on assets (ROA), and are generally more profitable. The statement filed by the Utah Department of Financial Institutions emphasizes "the Department calculates an average Return on Average Assets ratio of 1.04 percent for FDIC insured depositories, whereas industrial banks average 2.48 percent." These numbers are not just a snapshot in time; ILCs have consistently outperformed other banks in both ROA and capital-to-assets ratios for the past 35 years.

During the Great Recession, all but one ILC survived (most remained profitable). The Federal Reserve did require several entities to close the operations of the ILC they owned as a condition of receiving TARP funding. All of these ILCs were sound prior to the closure - none required assistance.

Yet, despite the incontrovertible evidence, there are voices who continually claim that ILCs present a threat to the FDIC banking system. Please note, these allegations are frequently made without any documentation. There is no evidence which disputes the strength of the ILC model.

III. ILCs are an intentional creation of Congress.

The ILC exemption from the Bank Holding Company Act ("BHCA") was an intentional creation of Congress when it enacted the Competitive Equality Banking Act of 1987 (CEBA). This status was not an accidental oversight. Congress made that decision in order to allow the continuing development of industrial banks, which were subject to regulatory oversight as banks but were owned by companies exempt from the BHCA's activity restrictions. In the 33 years since the enactment of CEBA, Congress has repeatedly visited and modified the regulatory structure for our nation's banks and chosen to leave the regulatory structure for ILCs intact. Congressional intent in this area is clear. Gramm-Leach-Bliley, which ended commercial ownership of unitary thrift holding companies, left ILCs untouched.

IV. ILCs are highly regulated by federal and state regulators

The FDIC and state regulators have broad authority over both ILCs and their parent companies to take any and all actions necessary to protect the bank, its depositors and the deposit insurance fund. The FDIC has frequently affirmed its authority to regulate the industrial banks and their transactions and relationships with their parents and affiliates.

First and foremost, the ILCs themselves are regulated by both their chartering state and the FDIC, and must comply with all relevant safety and soundness regulations, and all consumer protection regulations.

The FDIC's recent rulemaking to codify existing regulatory practices further highlights the agency's ample authority to ensure that the parent company of an ILC, be it financial or commercial, does not pose a risk to the institution or to the U.S. financial system. Both the state regulators and the FDIC have the authority to examine for compliance with Federal Reserve Act Sections 23A and 23B and ensure that the ILC and its parent interact in a safe and sound manner. They can also require that the parent serve as a source of strength to the bank should it become distressed. The regulators can examine the parent company's records and management of the ILC as needed should concerns arise. Finally, as former Chairman Gruenberg noted, the FDIC and the appropriate state banking regulator can limit the activities an ILC can engage in with a parent or affiliate if they are concerned about those activities' impact on the institution.

Many critics also raise concerns about conflicts of interest between an ILC and its affiliates but fail to understand how Sections 23A and 23B of the Federal Reserve Act, applicable to all industrial banks and their affiliates under provisions of the Federal Deposit Insurance Act, effectively prevent any such conflicts of interest. ILCs operate as fully independent entities and can only engage in transactions with affiliates that benefit the bank.

IV. ILCs are innovative partners

The ILC model allows for innovative but safe products for American consumers. Fintechs and other financial service companies continually seek partnerships with ILCs to provide these features. These are partnerships that should be encouraged by Congress. In all cases, the regulators require the ILCs treat all loans the same, even if that loan is sold. The ILC is responsible for full legal compliance through advertising to servicing to collections regardless of whether it holds the loan.

Also, some innovative financial service companies may seek an ILC charter. The rules promulgated by the FDIC and state authorities make this extremely difficult and require a number of commitments from the parent company. Our association fully supports such rigorous demands. The ILC model has worked because it is heavily regulated and requires intense capitalization. Yet, they remain innovative and flexible.

Some "fintech" companies have considered applying for an ILC, and one such company, Square, was recently approved for an industrial bank charter and federal deposit insurance. It is important to understand that this represents an opportunity only for a company with well-developed products and services that is ready to comply with the broad range of standards and requirements applicable to all banks to help ensure they operate safely. Companies in the early stage of development do not qualify. For various reasons including the restrictions in Sections 23A and 23B, mega technology companies such as Amazon cannot own a bank offering loans and other financial services to customers of an affiliate. Those large tech companies can offer a full array of banking services to their customers – the activities critics say pose a systemic risk to the economy and banking industry -- by partnering with an independent bank, and many do that now.

V. ILCs benefit American consumers with safe innovative financial services

In summary, ILCs are among the safest and soundest banks in the U.S. system, and they do not create systemic risk. What they do create is competition and innovation in the U.S. banking system. ILCs are small, innovative banks that help create and test new products for consumers and businesses.

Sincerely,

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