National Association of Industrial Bankers

August 10, 2020

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Crapo, Ranking Member Brown, Chairwoman Waters, and Ranking Member McHenry:

We are writing in response to a recent joint trade association letter sent by the Bank Policy Institute (BPI), the Center for Responsible Lending (CRL), and the Independent Community Bankers of America (ICBA). This letter calls on Congress to enact a three-year moratorium on new Industrial Loan Company (ILC) charters, to provide Congress the time to address the ILC loophole. Their letter is long on opinion, but unfortunately short on actual facts. It not only misrepresents the nominal risk posed by ILCs to the US financial system, but it also misstates the regulation of ILCs and the role they play in the US economy.

This letter will correct those mistakes and provide you with an accurate story about ILCs, their regulation, the risks they pose, and how they are helping to grow the economy and provide much-needed innovation to the US banking system.

At the outset, the most telling fact that merits repeating every time the subject of ILCs is raised is that the FDIC-insured industrial banks in Utah and Nevada have for the past 35+ years been the best capitalized, most profitable, safest and soundest group of banks insured by the FDIC. This is fact, not hyperbole. Nothing in the history of the industrial banks provides any basis to argue that they present a significant risk to the FDIC, the banking industry, or the nation's economy. The position taken by these trade associations is pure political posturing advanced to try to stifle competition.

ILCs are an intentional creation of Congress, not a loophole

The first and most important point to make is about the joint trade associations' assertion that ILCs operate under a "loophole" that exempts them from the Bank Holding Company Act (BHCA). The ILC exemption from the BHCA is not a loophole, it is an intentional creation of Congress. ILCs are exempt from BHCA supervision due to an intentional act 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 has repeatedly 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. During negotiations of what became the Dodd-Frank Act, the Administration recommended removing the ILC exemption from the BHCA, but Congress chose not to do so.

Over the past four decades, the FDIC has twice imposed moratoriums on grants of deposit insurance to new ILC charters for the express purpose of allowing Congress to review the exemption for ILC parents and affiliates from the Bank Holding Company Act. The moratorium specified in the Dodd-Frank Act also required the GAO to study the issue and report to Congress 18 months before the moratorium expired. Congress allowed both moratoriums to expire without choosing to end the ILC exemption from the BHCA. No incident since would warrant considering the issue again. How many times must Congress decline to change the current law before the trades will stop demanding another moratorium? The legislative record demonstrates that ILCs are not a loophole: Congress intended to allow ILCs their unique status and has repeatedly affirmed it.

ILCs are the safest, strongest financial institutions in the nation

Another, even more spurious allegation in the joint trades letter is that ILCs present a safety and soundness risk to our financial system. An empirical examination of ILC data shows that this is far from the truth. ILCs are better capitalized and more profitable than their commercial banking peers. Recent FDIC call report data show that in comparison to commercial banks, ILCs are better capitalized, have a higher return on assets (ROA), and are generally more profitable. Commercially owned industrial banks have a higher capital to assets ratio than the banking industry as a whole. As of December 31, 2019, the US banking industry had $18.6 trillion in assets and $2.11 trillion in capital, resulting in a capital-to-assets ratio of 11.3 percent. Industrial banks have $272.3 billion in assets and capital of $33.2 billion, resulting in a capital-to-assets ratio of 12.2 percent. Commercially owned industrial banks have $15.2 billion in assets and $2.2 billion in capital, resulting in a capital-to-assets ratio of 14.8 percent.

Likewise, for the year ending December 31, 2019, the banking industry reported net income totaling $232.8 billion, resulting in an annualized return on assets (ROA) of 1.27 percent. Industrial banks' net income for the period totaled $9.23 billion, resulting in an annualized ROA of 3.54 percent. Commercially owned industrial banks reported net income totaling $293.7 million during that period, resulting in an annualized ROA of 2.01 percent. These numbers are not just a snapshot in time; ILCs have outperformed other banks in both ROA and capital-to-assets ratios for the past 35 years.

Furthermore, as those numbers show, of the $18.6 trillion in total banking assets ILCs account for only $272.3 billion, or less than 1.5 percent of total banking assets. Combining all ILC assets would not equal a top 12 bank in the United States. Commercially owned ILCs are an even smaller portion of total banking assets at only $15.2 billion, representing well under one percent of total banking assets; combining their assets would not equal a top 100 bank. The numbers speak for themselves: ILCs pose no threat to the banking system.

ILCs are highly regulated by federal and state regulators

One of the longest-lived myths perpetuated by opponents of the ILC charter is that the FDIC does not have sufficient authority to regulate ILCs, their affiliates or their parent companies. The FDIC has 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. Regarding the supervision of an ILC's parent company, former FDIC Chairman Martin Gruenberg made this clear in response to questions from the Senate Banking Committee:

> the FDIC has the authority to examine the affairs of any affiliate, including the parent and its subsidiaries, as may be needed to disclose the relationship between the ILC and the affiliate, and the affiliate's effect on the institution. And, similar to other insured institutions, the FDIC can prohibit an insured ILC from engaging in activities with an affiliate or any third party that may cause harm to the ILC. In the event supervisory concerns are noted, the FDIC may pursue the same enforcement powers authorized with respect to any other insured institutions.

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.

Commercially owned ILCs are not a privacy risk

The joint trades try to raise the specter of commercially owned ILCs posing a privacy risk to consumers. This too is far more myth than fact. Again, ILCs are regulated depository institutions that must comply with all consumer protection laws, including the privacy requirements of Gramm-Leach-Bliley. They have the same obligation as any other depository institution to safeguard consumer data, notify customers of how data is used, and provide opt-out opportunities.

We agree that the parents of ILCs should not misuse bank customer data, but we believe that the state regulators and the FDIC should address any such concerns during their review of ILC applications; should they identify a risk of consumer data being misused, regulators can and should address it then. If broader risks of banks improperly sharing customer data with a parent holding company or affiliate emerge, Congress should deal with that so that all banks are required to safeguard customer data, not just ILCs.

It is apparent, however, that the joint trades are not serious about a privacy discussion. Instead, they are serious about using privacy as a means to thwart competition in the marketplace. The most obvious example of this is that they propose a moratorium on ILC applications in response to their alleged privacy concerns, rather than a change to privacy laws or regulations.

The merging of technology and financial services does warrant a discussion about whether privacy laws need to be updated. We are happy to have that discussion. NAIB members believe in protecting their customers and their data. This discussion, however, is not what the joint trades are seeking. They simply want to impose a moratorium on ILCs to prevent competition and try to forestall innovation. We urge you to see through this flimsy argument.

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.

Some incumbent banks are looking to stifle this competition by asking Congress to place a moratorium on new charters for ILCs, which represent only 25 institutions and 1.4 percent of domestic banking assets. What do the incumbent banks have to fear, besides competition? Nothing. This request for a moratorium is a simple attempt to stifle competition and deprive consumers and businesses of choice.

We ask you to look at the facts, which make clear that ILCs are not a threat to the banking system, the U.S. economy, or consumers. They provide needed competition in a safe and regulated manner. Rather than trying to stop this, our nation’s banks of all types and sizes should be calling for more successful leading-edge companies to explore a banking charter. Such inventive organizations applying for banking charters takes financial innovation from the fringes of the legal system into a space where that innovation can happen while being regulated for safety, soundness and consumer protection. Congress should fully support this effort.

Thank you for your time and consideration.

Sincerely,

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