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Jennifer Jones, Deputy Executive Secretary
Federal Deposit Insurance Corporation
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Re: Industrial Loan Companies RIN 3064–ZA48

Dear FDIC:

Background

There has been a long-standing distrust of the financial power of large and powerful financial institutions in the United States. In the 20th century, the U.S. prohibited interstate banking, and many states prohibited even branch banking. Some enterprises got around this by establishing holding companies to own multiple banks in different states. Congress responded by passing the Bank Holding Company Act (BHCA) in 1956. BHCA gave

[1] All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else. I am very grateful to Georgetown University for financial support. Over the years I have served as a Visiting Academic Fellow at the NASD (predecessor to FINRA), served on the boards of the EDGX and EDGA stock exchanges, served as Chair of the Nasdaq Economic Advisory Board, and performed consulting work for brokerage firms, stock exchanges, other self-regulatory organizations, government agencies, market makers, industry associations, and law firms. I am the academic director for the FINRA Certified Regulatory and Compliance Professional (CRCP®) program at Georgetown University. I've also visited over 95 stock and derivative exchanges around the world. As a finance professor, I practice what I preach in terms of diversification and own modest and well-diversified holdings in most public companies, including brokers, asset managers, market makers, and exchanges.

the Fed regulatory authority over bank holding companies in order to plug the loophole in the interstate banking ban.

Some entities that cannot become bank holding companies because of their structure or their non-banking activities nevertheless want to add the business of banking to their portfolio of activities. They thus seek to establish Industrial Loan Companies (ILCs) with state charters that would be regulated by the FDIC. Potential ILCs include fintechs, non-financial commercial firms, and financial companies wishing to augment their product lines.

Opposition to letting more entities get ILC charters generally comes from two camps: First, some banks just want less competition from any source and will raise a number of self-serving arguments for blocking any and all competition. Second, the "Big is Bad" crowd just hates the idea that some big non-financial firm might be able to use an ILC to get bigger and badder. They needlessly fear that a mega-corporation will spawn a mega-bank that turns us all into serfs forced to serve The Man. This fear is groundless as there are plenty of other anti-trust tools to prevent such an outcome. Furthermore, it is not the remit of the FDIC to make anti-trust policy.

Congress has not banned ILCs. The FDIC should approve ILCs that meet the statutory criteria.

Neither the "We don't want competition" nor the "We don't like big" arguments merit blocking all ILCs. If Congress wanted to ban ILCs, it could have easily done so and has not. The Federal Deposit Insurance Act (FDIA) contains clear criteria for the FDIC to consider before approving an ILC application. The FDIC should approve ILCs that meet the criteria, and not use the criteria as a subterfuge to block all ILCs.

The FDIC is seeking comment on how to interpret its statutory mandate in determining whether to grant approval to these wannabe banks.[2] Here are the statutory criteria from Section Six of FDIA:

> *(1) The financial history and condition of the depository institution.*
>
> *(2) The adequacy of the depository institution's capital structure.*
>
> *(3) The future earnings prospects of the depository institution.*
>
> *(4) The general character and fitness of the management of the depository institution.*
>
> *(5) The risk presented by such depository institution to the Deposit Insurance Fund.*
>
> *(6) The convenience and needs of the community to be served by such depository institution.*
>
> *(7) Whether the depository institution's corporate powers are consistent with the purposes of this Act.*

There are no special criteria for ILCs, nor is there a blanket ban on ILCs. The considerations should be the same regardless of whether the applicant is an ILC or some other institution. The fact that Congress has not explicitly banned ILCs indicates that the FDIC should not reject all ILCs, but should examine each applicant with respect to these criteria.

The first four criteria are pretty straightforward common-sense requirements for any institution seeking a deposit guarantee and need no further commentary.

[2] 90 FR 34271 - Request for Information on Industrial Banks and Industrial Loan Companies and Their Parent Companies

Risks need to be evaluated individually on a case-by-case basis.

Criterion Five addresses the risk to the Deposit Insurance Fund. Again, this is a common-sense criterion. All depository institutions present some level of risk. The existence of a particular risk in itself is not a deal breaker. The FDIC needs to examine each case individually and assess the risk along with wind-down plans.

Given the diversity of applicants, there is no one-size-fits-all method for analyzing all applicants. A fintech startup using a novel and unproven technology presents higher operational risk that something will blow up. Again, this in itself is not grounds for an automatic rejection, but calls upon the FDIC to carefully examine the risk controls in place and contingency plans for when things blow up. Consider whether the operational risk adjustment in capital standards is adequate.

At the other extreme, a financial company with a long track record presents less risk: Such a firm has a long history managing a financial institution in a highly regulated environment. It knows how to manage risk and maintain regulatory compliance. Its captive bank can safely be treated like any other FDIC-insured bank.

Systemic risk is also an important consideration. If one institution fails, contagion may result in runs on other institutions leading to widespread failures and thus stress on the Deposit Insurance Fund. Again, the degree to which a particular applicant or group of applicants presents systemic risk considerations should be handled on a case-by-case basis. The FDIC should pay particular attention to wind-down plans in the event of trouble.

However, big is not necessarily bad when it comes to systemic risk. A larger parent can present less risk when it is well diversified geographically and has diversified business lines.

The FDIC should rightly examine whether the captive nature of a particular ILC presents excessive risk. Some may argue that such an institution is more likely to fail because it has an undiversified customer base. For example, suppose all of the customers of an ILC are purchasers of vehicles from the parent car company, and the car company fails. What happens then? As long as the borrowers are still paying off their car loans, the ILC would survive. Chrysler Financial survived the financial crisis of 2008 despite the bankruptcy of its parent.[3] Many other non-ILC banks with diversified customer bases also failed during the crisis.

Likewise, the FDIC should examine the controls in place to prevent assets from tunneling out of the ILC and into the parent while the parent is in its death throws.

However, a captive ILC may actually present far less risk to the Fund than a standalone bank due to support from the parent. The FDIC should closely examine the solvency of the parent, and the degree to which the parent will support the ILC in the event of trouble.

Again, the existence of such monoline risk should not be grounds for automatic rejection. The FDIC should examine each applicant individually, assess the risk, and pay close attention to capital adequacy as well as resolution plans in the event of trouble at the parent.

Communities benefit from innovation and competition.

Criterion Six examines the "convenience and needs of the community to be served by such depository institution." Notice that the focus is on the needs of the ***community***, not the desires of entrenched incumbent banks. In general, competition is good for the community. Allowing new entrants to

[3] Chrysler Financial did receive a TARP loan, which is repaid "relatively quickly" according to the Congressional Research Service. https://www.everycrsreport.com/reports/R41940.html Note that the troubles that affected General Motors Acceptance Corporation (GMAC) were driven by its losses on mortgages, not car loans. Indeed, it was GMAC's attempts to diversify away from car loans that got it into trouble.

deliver new products is a net benefit for most communities. Entrants can provide newer technology in saving, borrowing, bill paying, and more.

Note that the CRA applies to ILCs just as it applies to other banks, so an ILC is on a level playing field with other banks in serving communities. Indeed, bringing in more banks can help better serve most communities. Bringing in newer financial technologies will also better serve most communities.

The customers of an ILC that provides services only to customers of the parent *is* a community in and of itself. Such an ILC may be able to provide new products or better terms to its customers. This is a benefit to that community. The self-serving argument from competing banks that such better products will kill competition and thus harm the community does not hold water.

Again, the FDIC should examine each applicant separately. A brick-and-mortar-based outfit will have a different impact on communities than an online only outfit.

Approving safe ILCs is "consistent with the purposes of the Act."

Criterion Seven examines whether the applicant's "corporate powers are consistent with the purposes of this Act." One could narrowly construe this criterion to mean corporate powers as what the corporation can and cannot do. After all, FDIA has its own section, Section 9, on the corporate powers of the FDIC itself. The very first enumerated power is "To adopt and use a corporate seal."

I strongly doubt that Congress was too concerned about what kind of corporate seal an applicant has. That an applicant has basic corporate powers to conduct business is implicit in the other criteria. Congress is basically asking whether the structure and activities of the applicant "are consistent with the purposes of this Act."

And what are those purposes? As the FDIC proclaims on its web site:[4]

> *"The mission of the Federal Deposit Insurance Corporation (FDIC) is to maintain stability and public confidence in the nation's financial system. In support of this goal, the FDIC:*
>
> - *Insures deposits,*
> - *Examines and supervises financial institutions for safety and soundness and consumer protection,*
> - *Works to make large and complex financial institutions resolvable, and*
> - *Manages receiverships."*

A regulatory system that processes reasonable requests in a timely and transparent manner is essential for maintaining public confidence in our financial system. A regulatory process that inhibits competition by blocking new and different entrants makes people think that the game is rigged and thus reduces public confidence. Regulatory opacity also reduces public confidence. The FDIC should approve any ILC application in a timely and transparent manner as long as the ILC can demonstrate it will operate in a safe and sound manner.

ILCs should be treated like any other bank: Approvals should be handled by the applicable FDIC regional authority and not subject to vote by the FDIC Board. Other banks under BHCA are not required to obtain FDIC Board approval and neither should ILCs.

Respectfully submitted,

[4] https://www.fdic.gov/about/what-we-do

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