NCRC
National Community Reinvestment Coalition

May 26, 2020

RE: Comment on Proposed Rule: Parent Companies of Industrial Loan Companies, RIN 3064-AF31

To Whom it May Concern:

The National Community Reinvestment Coalition (NCRC), a coalition of 600 community-based organizations dedicated to increasing access to capital and credit for traditionally underserved communities, opposes the FDIC's proposal to codify the procedures for industrial loan companies to apply for and receive deposit insurance. The FDIC has not adequately explored the significant safety and soundness and anti-trust complexities of its proposal. In addition, the proposal does not develop adequate procedures and analyses for considering factors related to Community Reinvestment Act (CRA), the convenience and needs, and fair lending and consumer protection.

Significant Safety and Soundness, Anti-Trust, and Fair Lending Risks

NCRC agrees with the conclusions in Professor Arthur Wilmarth's letter of April 10 regarding the increased risk and anti-competitiveness posed by the FDIC's proposal.[1] Parent companies of industrial loan companies (ILCs) can be commercial entities. For six decades spanning the Great Depression through the 1980s, banking law outlawed the combination of commercial and financial companies in the wake of the widespread speculation and failure of these combinations leading up to the Great Depression. In 1987, Congress passed the Competitive Equality Banking Act (CEBA) that allowed commercial entities to own ILCs. Yet, Senator Jake Garn (R-UT), the author of this provision, stated that "it was never my intent, as the author of this particular section, that any of these industrial banks be involved in retail [commercial] operations."[2] In fact, industrial loan banks originally established in the early 1990s offered small consumer loans to industrial workers because commercial banks were unwilling to do so.[3]

Large scale lending associated with ILCs resulted in catastrophic and spectacular failures in the years leading up to the financial crisis. Freemont Investment and Loan, which made high volumes of subprime loans, failed. CIT-Group, a commercial lender as well as a subprime mortgage lender, failed. GMAC, the lending arm of GM, had to be bailed out.[4] The FDIC does not indicate how these past problems would be avoided under its proposal.

Dramatically expanding beyond the original mandate of industrial banks would pose serious risks to the economy. ILCs would be tempted to be biased towards their commercial parents and

[1] Comment letter of Arthur E. Wilmarth, Jr., Professor of Law George Washington University Law School, April 10, 2020, https://www.fdic.gov/regulations/laws/federal/2020/2020-parent-companies-of-industrial-banks-3064-af31-c-002.pdf

[2] Wilmarth, p. 4.

[3] Notice of Proposed Rulemaking (NPR), FDIC, *Parent Companies of Industrial Banks and Industrial Loan Companies*, Federal Register, Vol. 85, No. 62, Tuesday, March 31, 2020, RIN 3064–AF31, p. 17772.

[4] Wilmarth, pp. 6-9.

refuse to lend or lend with onerous terms and conditions to the competitors of the parents. This distorts economic activity. If they were large enough lenders, the ILCs would reduce overall economic efficiency if they starved robust competitors of loans. The scale of ILCs in today's economy could also become very large, risking the rise of systemically important firms that the federal government would consider as too big to fail. In the mid-2000's, Walmart applied for an ILC charter but withdrew it in the face of withering criticism. Last year, Rakuten, which has been described as the Japanese Amazon, applied for an ILC charter and deposit insurance.

This Rakuten precedent should give the FDIC pause. How would the FDIC handle an ILC application by Facebook or Google or Amazon? Would ILCs owned by such large corporations pose significant anti-trust issues in terms of creating oligopolies in the lending marketplace, especially considering that the top four banks in the country each already have more than $1 trillion in assets?[5] If such oligopolies emerge, not only could pricing become unfavorable, but the possibilities of fair lending violations emerge. The recent experience of the Payment Protection Program (PPP) during the COVID crisis shows that large banks tend to favor their existing customers. What would happen if a large-scale commercial retailer obtains an ILC charter and primarily lends to its customer base that could be primarily white and affluent?

The FDIC proposal does not consider these critical safety and soundness and economic efficiency and equity questions. The size of the ILC sector is already large; as of December 2019, 23 industrial banks had $141 billion in assets according to the FDIC.[6] The size of this sector suggests that existing ILCs could rapidly expand or several new ones gain charters in the wake of the FDIC finalizing its proposal.

It is not clear that the FDIC would be prepared to consider adequately the multitude and interconnectedness of the safety and soundness, anti-trust, and fair lending issues accompanying a rapid expansion of this sector. The FDIC proposal merely codifies that the agency will require some level of transparency and disclosure on the part of the ILCs regarding their organizational structure and that the FDIC will examine them. However, details regarding the robustness of the exams are notably absent from the proposal, rendering it impossible for the public to judge the adequacy of these exams to deal with potentially complex companies.

The FDIC also does not offer any guidelines regarding when the sector would become unsafe and anti-competitive. For example, does the agency expect that it will have to alter the Herfindahl-Hirschman index measuring levels of concentrations at a metropolitan, rural, or state level to consider adequately the anti-trust implications of commercial and financial conglomerates? What about financial stress tests introduced by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank). Would these need to be upgraded in any manner?

[5] National information Center, FFIEC, https://www.ffiec.gov/npw/Institution/TopHoldings
[6] NPR, p. 17773.

The agency also does not discuss whether any limits on the size of the commercial parent or the ILC should be imposed. Current banking law places a limit on the percentage of deposits that a bank can control (no more than 10 percent nationally). Applying variations of anti-trust tests like Herfindahl-Hirschman to the commercial retail and banking activities of ILCs would most likely suggest prudent limitations. Rakuten, for example, is most likely too large and poses too many risks to be granted an ILC charter.

CRA and Convenience and Needs Factors Under-developed

Just like safety and soundness, anti-trust, and fair lending deficiencies, the CRA and convenience and needs factors for ILC charter applications remain under-developed. The FDIC does not discuss CRA and convenience and needs in the preamble of its proposal. The agency asks in Question #19 whether the current Interagency Charter and Federal Deposit Insurance Application form requires enough information from the applicant so that the public can judge the adequacy of the applicants' CRA-related plans.[7] Astonishingly, the FDIC's request for comments is silent on its proposal to change the CRA regulations and whether those proposed changes would impact the level of information required in the application form.

Assessment Area Procedures Need to be Finalized

The FDIC cannot finalize this proposed rule until the CRA rulemaking has concluded because the Interagency Charter form requires applicants to describe their assessment areas (AAs), which are geographical areas on CRA exams. The Office of the Comptroller of the Currency's (OCC's) final rule includes major changes to AAs. In addition to areas including bank branches, the proposal would add AAs when nontraditional banks collect more than 50 percent of their deposits outside of branch networks and when a bank collects more than 5 percent of its deposits in a geographical area, which could be a state, metropolitan area or county. NCRC, in our comment letter on the CRA proposal, stated that the agencies must use currently available lending data to designate additional AAs for non-traditional banks.[8] Deposit data for purposes of designating additional AAs does not exist while the lending data would be available via the Home Mortgage Disclosure Act (HMDA) and CRA small business/farm data.

The current AA procedures fail to hold non-traditional banks accountable for serving low- and moderate-income (LMI) borrowers and communities in which they operate. The ILC charter applications that have been submitted in recent years usually state that the applicant will serve the area in which it has its headquarters and then will propose a vague national obligation associated with the national reach of internet delivery of its products. The national obligation sometimes entails that the applicant will delivery financial education over the web or in unspecified locations.

[7] NPR, p. 17782.

[8] NCRC Comments Regarding Notice Of Proposed Rulemaking (Docket ID OCC–2018-0008 And RIN 3064-AF22), https://ncrc.org/ncrc-comments-regarding-notice-of-proposed-rulemaking-docket-id-occ-2018-0008-and-rin-3064-af22/

In contrast to recent applications, NCRC believes that geographic specific obligations in areas beyond the applicant's headquarters is possible. NCRC proposes that an applicant for ILC charters that will deliver loans and services primarily via the internet or other non-traditional means can be evaluated at a state level and in a selection of metropolitan areas and rural counties. The non-traditional lenders can be compared to their peer non-branch lenders, which usually issue lower percentages of loans to LMI borrowers and communities than traditional branch-based institutions.[9] A comparison to the aggregate (both traditional and non-traditional lenders) should also be included but not weighted as heavily. This procedure would be followed so the non-traditional lenders would not fail their CRA exams out of the gate, but they should not earn an Outstanding or High Satisfactory rating if they compare poorly to the aggregate.

In addition, the metropolitan and rural areas selected for AAs could be those in which the applicant has a significant volume of activity and where the overall loans per capita is relatively low. It is desirable to establish AAs in underserved areas for non-traditional lenders so these areas can have more access to credit. Research also suggests that some non-traditional lenders are already to some extent filling gaps in areas with relatively few branches as their loan market share tends to be higher in these areas.[10]

NCRC's request for more specificity regarding assessment areas is consistent with the business plan of the interagency form. The form asks internet-based organizations to be more specific on market areas to be served since the internet is global. In other words, the agencies' instructions acknowledge the global reach of the internet but also suggest that most institutions nevertheless have geographical market areas in mind.[11] In sum, the FDIC cannot finalize its proposal until it has updated AA procedures so that it is more effective in examining the lending and business activity of non-traditional lenders applying for ILC charters.

CRA Plans

In addition to assessment areas, the interagency form requires applicants to describe their CRA plans. CRA plans include an assessment of credit needs, the evaluation test the applicant chooses, and the products, programs, and activities that the applicant would undertake to meet community needs. The recent ILC applications tend to answer these important questions partially and incompletely.

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[9] NCRC Comment Letter on CRA proposal discusses how non-traditional lenders and banks without branches perform compared to branch-based institutions on retail lending tests.

[10] Julapa Jagtiani and Catharine Lemieux, *Do Fintech Lenders Penetrate Areas That Are Underserved by Traditional Banks?*, Working Papers, Federal Reserve Bank of Philadelphia, https://www.philadelphiafed.org/-/media/research-and-data/publications/working-papers/2018/wp18-13.pdf

[11] Interagency Charter and Federal Deposit Insurance Application, https://www.fdic.gov/formsdocuments/interagencycharter-insuranceapplication.pdf, p. 21.

The FDIC statement of policy indicates that applicants for deposit insurance will be judged on their ability and willingness to meet the convenience and needs of the community.[12] This mandate suggests that applicants should use their capacities and talents to meet needs. NCRC has been astonished that financial technology institutions that specialize in offering products over the internet (fintechs) usually answer this mandate by saying they will offer some community development financing or will offer financial education (the method and means will be developed later after approval of the application). While laudable, these activities do not reflect a sophisticated utilization of the applicants' talents to connecting LMI populations to banking and financial services. A more appropriate response would be that a fintech applicant would use its marketing expertise to advertise in LMI communities in its AAs. Moreover, it would offer financial education and counseling via the internet and via partners (nonprofit or public sector) in specific underserved communities.

A CRA plan aiming to satisfy the willingness and ability standard would also establish quantitative performance goals for its various products. An applicant could describe previous years' volumes of loans and other products for LMI borrowers and communities and could identify and describe feasible increases in these products for LMI populations. The descriptions should also include how these products are affordable and would not result in unsustainable debt levels. Finally, goals regarding whether the applicant will offer percentages of loans to LMI borrowers and census tracts equal or greater than the aggregate or its peers (with peers identified) in its AAs would enable the public to judge the adequacy of its commitment to affirmatively and continually serve credit needs per the CRA mandate. The applicant should describe its rationale for its goals including recent past performance relative to peers and/or aggregate and how it thinks its product offerings might improve upon the comparisons in future years.

The FDIC could also encourage the negotiation of Community Benefit Agreements (CBAs) as part of ILC charter applications. NCRC works with our members and financial institutions on a collaborative process to create CBAs where nonprofit and bank leaders discuss community needs and opportunities for CRA-related financing. CBAs commit banks to increasing CRA activity, and directing it to where it is needed most. One would be hard-pressed to think of a more ideal model of CRA implementation. Yet, the regulators do not have a process for recognizing these commitments and bank progress towards completing them.

Recognition of CBAs has gained momentum lately. CBAs negotiated with NCRC have been mentioned in four recent merger approvals as evidence of how banks are meeting the convenience and needs of community members, including in the FDIC's approval of BB&T and SunTrust.[13] The Treasury Department recognized CBAs as an "effective tool" to "demonstrate

[12] FDIC Statement of Policy on Applications for Deposit Insurance, see section on convenience and needs of the community to be served, https://www.fdic.gov/regulations/laws/rules/5000-3000.html
[13] FDIC Approval of BB&T- SunTrust Merger, November 2019, pgs. 9-10, 15, https://www.fdic.gov/news/news/press/2019/pr19111a.pdf. Federal Reserve Approval of KeyBank-First Niagara Merger, July 2016, pgs. 17-18, 27, https://www.federalreserve.gov/newsevents/pressreleases/files/orders20160712a1.pdf/ Federal Reserve Approval of

how [merger] application[s] would benefit the communities served."[14] The regulators should work with community groups and banks on the development of a process for recognizing CBAs, and for their implementation to become a factor on applications and CRA performance evaluations.

Fair lending and Consumer Protection Law Compliance

The interagency form also lacks any section asking applicants to describe in detail how they will comply with fair lending and consumer protection law. This is particularly important in the case of fintechs seeking ILC charters. A number of fintechs use newer underwriting techniques that are controversial and do not seem to have objective criteria for assessing creditworthiness. These applicants need to describe how they would make sure that any underwriting of this nature would not result in disparate impact. In addition, they need to describe how internet-related disclosures would not shortcut the usual TILA-RESPA disclosures regarding loan terms and conditions.

The internet can be alluring in its simplicity and speed. How would applicants ensure that they were not employing unfair, deceptive, and abusive advertising? The FDIC would not want to invite a rash of new and unscrupulous market activity targeting vulnerable populations unfamiliar with banking and lending. The FDIC needs to further develop this ILC chartering proposal that is far from ready in promoting consumer interests.

Conclusion

NCRC believes that the FDIC proposal to codify ILC application procedures is woefully incomplete. It does not explain through careful analysis, including reviewing data, how anti-trust and safety and soundness tests could be constructed to ensure that the marketplace remains competitive and safe and sound. The CRA and fair lending considerations for ILC charters are also not developed. If the FDIC was to finalize this proposal, it would risk the rise of an anti-competitive and risky sector that would also have comprised CRA and fair lending compliance. After the destruction and rise of inequality caused by COVID, this proposal would make a national economic recovery that benefits all segments of the population more difficult.

On behalf of NCRC and the undersigned organizations, thank you for the opportunity to comment on this matter. Please ask either Josh Silver, Senior Advisor, or myself if you have any questions on 202-628-8866.

Huntington-FirstMerit Merger, July 2016, pg. 31, https://www.federalreserve.gov/newsevents/pressreleases/files/orders20160729a1.pdf, Federal Reserve Approval of Fifth Third-MB Financial Merger, March 2019, pgs. 14 and 20, https://www.federalreserve.gov/newsevents/pressreleases/files/orders20190306a1.pdf.

[14] Memorandum for the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation from the Department of Treasury, *Community Reinvestment Act – Findings and Recommendations*, April 2018, p. 22, https://home.treasury.gov/sites/default/files/2018-04/4-3-18%20CRA%20memo.pdf.

Sincerely,

[redacted]

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National
Grounded Solutions Network
National Association of American Veterans, Inc.
National NeighborWorks Association

Alaska
AKPIRG

Alabama
Community Action Association of Alabama
Community Service Programs of West Alabama, Inc.

California
California Coalition for Rural Housing
California Reinvestment Coalition
California Resources and Training
Color of Change
EAH Housing
Peoples' Self-Help Housing
Vermont Slauson EDC

Connecticut
Neighborhood Housing Services of Waterbury

District of Columbia
Can I Live, Inc.

Delaware
Cornerstone West CDC
Delaware Community Reinvestment Action Council, Inc.

Ellendale Community Civic Improvement Association

Florida
Community Reinvestment Alliance of South Florida
Florida Housing Coalition
Goldenrule Housing & Community Development Corp Inc
Metro North Community Development Corp.

Georgia
Georgia Advancing Communities Together, Inc.

Hawaii
Hawai'i Alliance for Community-Based Economic Development

Illinois
Brighton Park Neighborhood Council
Illinois People's Action
NW HomeStart, Inc
The UIC John Marshall Fair Housing Legal Support Center

Indiana
HomesteadCS

Kentucky
Metropolitan Housing Coalition
REBOUND, Inc.

Maryland
Maryland Consumer Rights Coalition

Massachusetts
Community Service Network INC

Michigan
New Hope Community Development
Southwest Economic Solutions

Missouri
Metropolitan St. Louis Equal Housing and Opportunity Council

Mississippi
North Montgomery Communities United for Prosperity (MCUP)

Montana
Montana Fair Housing, Inc.

New Jersey
National Housing Institute
New Jersey Citizen Action

New York
Fair Finance Watch
PathStone Enterprise Center

North Carolina
Community Link
Henderson and Company
Rebuild Durham IncNC
WE TEAM Youth Services, Inc

New Mexico
Southwest Neighborhood Housing Services

Ohio
Columbus Empowerment Corporation
Ohio CDC Association
Working In Neighborhoods

Oregon
CASA of Oregon

Pennsylvania
Community Action Committee of the Lehigh Valley
Community First Fund
Fair Housing Rights Center in Southeastern Pennsylvania
Liberty Resources, Inc.
Pittsburgh Community Reinvestment Group

Texas
Southern Dallas Progress Community Development Corporation
South East Houston CDC

Wisconsin
Metropolitan Milwaukee Fair Housing Council

West Virginia
Mountain State Justice