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National Association of Federally-Insured Credit Unions

B. Dan Berger
President & Chief Executive Officer

September 1, 2020

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: **Industrial Loan Companies**

Dear Chairman McWilliams:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to share the concerns of the credit union industry regarding the Federal Deposit Insurance Corporation's (FDIC) chartering of new industrial loan companies (ILCs). NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 121 million consumers with personal and small business financial service products. NAFCU also advocates for competitive equality between financial institutions and believes the safety and soundness of the financial system depends upon consistent application of prudential safeguards. However, the emergence of new ILCs only serves to create disparities within the financial regulatory landscape, which could invite excessive risk taking at a time of great economic uncertainty. Accordingly, we urge you to freeze current ILC chartering activity and consider a three-year moratorium on future ILC approvals.

In general, an ILC charter offers a nonbank parent company the opportunity to skirt registration as a bank holding company and avoid consolidated supervision by the Federal Reserve. This reduced oversight is further exacerbated by the fact that the FDIC lacks a complete range of statutory authority to fully supervise certain parent companies of ILCs.[1] As a result, the relationship between a nonbank parent and its ILC subsidiary lacks the degree of transparency and accountability intended by the *Bank Holding Company Act* (BHC Act) while at the same time inviting potentially hazardous comingling of banking and commercial activities. In other words, the ILC charter frustrates a core principle of prudential regulation: that a bank's parent company should serve as a transparent source of strength rather than an opaque source of risk. But awareness of these potential hazards has not deterred the FDIC from approving insurance applications for new ILCs at a time

[1] Under Section 10(b)(4) of the FDI Act, the FDIC is permitted to examine any insured depository institution, including an ILC, to examine the affairs of any affiliate, including the parent holding company, "as may be necessary to disclose fully (i) the relationship between the institution and the affiliate; and (ii) to determine the effect of such relationship on the depository institution." 12 U.S.C. § 1820(b)(4). However, this limited grant of authority is no substitute for the full range of examination powers necessary for consolidated supervision.

when the nation is still recovering from significant financial disruption caused by the COVID-19 pandemic. [2]

Approval of new ILC Applications Threatens the Stability of the Financial System

NAFCU believes that approving new ILC deposit insurance applications at this time could severely weaken the stability of the financial system and we urge the FDIC to suspend further chartering activity for at least three years so that a fully informed analysis of supervisory risks can be conducted. Furthermore, given technology companies' interest in acquiring banks, the FDIC should also take heed of the unique privacy risks that might exist should consumer financial records find their way into the hands of nonbank parent companies through affiliate data sharing arrangements. A moratorium would also give Congress appropriate time to consider whether the ILC charter is conducive to advancing the goals of financial inclusion given the nonbank parent's limited accountability to its banking subsidiary.[3]

Supporting a moratorium on chartering today would be consistent with past efforts to reign in the problematic ILC charter. Loopholes in federal law that permit nonbank companies to own ILCs have led states, Congress and the FDIC to consider various moratoria previously, in part due to the inherent risks of nonbank ownership. Between 1986 and 1997, the state of Utah placed a moratorium on new ILC charters after financial difficulties at several ILCs in the 1980s cost the state $45 million.[4] In 2006, shortly after Wal-Mart applied to create a new ILC and Home Depot attempted to acquire an existing bank, the FDIC imposed a moratorium on new approvals for ILC deposit insurance applications and change in control notices. At the time, the FDIC recognized that commercial ownership of ILCs could pose unique safety and soundness risks that were better left to Congress to resolve.[5] NAFCU and other banking trade associations expressed a similar view while also highlighting competitive concerns and the need for a fair playing field.[6]

Most recently, Section 603 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) imposed a three-year moratorium on ILCs controlled by commercial firms and prohibited the FDIC from acting favorably on applications for deposit insurance filed by such institutions after November 23, 2009. In the last financial crisis, ILC parents and affiliates that

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[2] *See* Pedersen, Brendan, "ILC freeze breaks with federal approvals for Square, Nelnet," American Banker (March 18, 2020), available at https://www.americanbanker.com/news/ilc-freeze-breaks-with-federal-approvals-for-square-nelnet

[3] In contrast to BHC Act banks, a non-BHC parent company would not be prohibited from commencing "new activities" if a subsidiary depository institution has a CRA rating that falls below satisfactory. See 12 CFR § 225.84.

[4] *See* Johnson, Christian A. and Kaufman, George G., A Bank By Any Other Name. . ., Economic Perspectives, Vol. 31, No. 4, 2007, Available at SSRN: https://ssrn.com/abstract=1028754

[5] *See* FDIC, "FDIC Extends Moratorium on Industrial Loan Company (ILC) Applications by Commercial Companies for One Year; Will Move Forward on Applications from Financial Companies," (January 31, 2007), available at https://www.fdic.gov/news/press-releases/2007/pr07007.html

[6] *See* NAFCU Letter to FDIC, (October 10, 2006), available at https://www.fdic.gov/regulations/laws/federal/2006/06c68ilc.pdf.

filed for bankruptcy included Lehman Brothers, General Motors, Flying J Inc., Capmark Financial Group Inc., CIT Group Inc., and Residential Capital, LLC.[7]

The FDIC Should Withdraw its Recent Proposal Regarding Parent Companies

Today, with the pandemic continuing to place unique strains on financial institutions and their customers, it would be prudent for the FDIC to focus on efforts to help ordinary consumers rather than devote analytical and legal resources towards advancing the financial ambitions of technology giants.[8] Consistent with the objective of imposing a moratorium on new ILC approvals, the FDIC should also withdraw its March 2020 proposed rule regarding parent companies of industrial banks and industrial loan companies.[9]

While the proposed rule does attempt to address significant safety and soundness concerns through a novel supervisory framework aimed at non-BHC Act parents ("Covered Companies"), it falls short of mitigating the inherent risk associated with a lack of consolidated supervision by the Federal Reserve. Even assuming the FDIC's proposed interpretation of its statutory authorities is correct, and the agency can obtain all eight "commitments" from a Covered Company, the extent of supervision would not be equivalent to what a BHC Act parent company otherwise receives through Federal Reserve oversight.

For example, the proposed commitment in 12 CFR § 354.4 would not authorize unlimited full scope examinations of Covered Companies or their nonbank subsidiaries. This inability to comprehensively examine Covered Companies could pose serious complications when attempting to monitor the activities of foreign companies whose legal risks or capital weaknesses might be spread across multiple nonbank entities. Furthermore, it remains doubtful whether the FDIC even has the capacity or expertise to successfully examine the specific variety of a large technology company most interested in acquiring a bank.

The proposal also fails to address fundamental privacy concerns should a non-BHC Act parent company acquire a total package of consumer information—both social and financial. The FDIC's decision to omit discussion of such risk in its proposal is not only concerning but suggests that there may be no solution that the FDIC can offer as a reasonable alternative to consolidated Federal Reserve supervision. Accordingly, the FDIC should withdraw its proposed rule until it has solicited broader public input on how a parent company's control of social and financial data might create unique cybersecurity, data protection, or fair lending risks, among others. Given the complexity of such risk, a moratorium on future ILC approvals is necessary so that all stakeholders and Congress can fully consider the consequences of inviting unprecedented mergers of banking and commerce.

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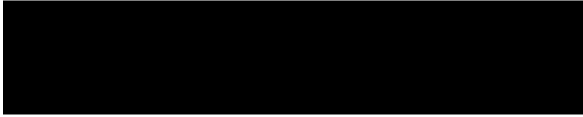
[7] *See* Statement of Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation on *De Novo* Banks and Industrial Loan Companies before the Committee on Oversight and Government Reform; U.S. House of Representatives; 2157 Rayburn House Office Building (July 13, 2016).
[8] Prior, Jon, "Rakuten refiles with FDIC for ILC charter," American Banker (May 29, 2020), available at https://www.americanbanker.com/news/rakuten-refiles-with-fdic-for-ilc-charter.
[9] Parent Companies of Industrial Banks and Industrial Loan Companies, 85 Fed. Reg. 17771 (March 3, 2020).

Conclusion

NAFCU appreciates your attention to this important issue. Should you have any questions or require additional information, please do not hesitate to contact me or Andrew Morris, Senior Counsel for Research and Policy, at (703) 842-2266 or amorris@nafcu.org.

Sincerely,



B. Dan Berger
President and CEO