ICBA
Independent Community Bankers of America®

INDUSTRIAL LOAN COMPANIES: CLOSING THE LOOPHOLE TO AVERT CONSUMER AND SYSTEMIC HARM

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Executive Summary and Introduction

ICBA urges Congress to pass an amendment to the Bank Holding Company Act of 1956 to permanently close the ILC loophole, just as Congress has closed past banking loopholes that threatened to undermine consolidated supervision and the separation of banking and commerce.

- **A loophole in the Bank Holding Company Act allows commercial companies and fintech companies to own or acquire industrial loan companies (ILCs) chartered by Utah and a handful of other states without being subject to federal consolidated supervision, leaving a dangerous gap in safety and soundness oversight.**
- **ILCs are the functional equivalent of full-service banks. Commercial company ownership of ILCs will effectively combine banking and commerce, contrary to long-standing American economic policy of separating banking and commerce. Federal law prohibits all other full-service banks, whether federally or state chartered, from being owned by commercial companies.**
- **In the new era of Big Data, social media and e-commerce conglomerates, artificial intelligence, and financial technology, we should be cautious before giving these companies yet more reach into the economic life of Americans by exploiting the ILC loophole.**
- **FDIC approval of new ILC deposit insurance applications would put the federal safety net (FDIC insurance), and ultimately the American taxpayer, at risk.**
- **A single state, Utah, representing less than one percent of the U.S. population, should not be allowed to unilaterally determine national financial regulatory and economic policy.**
- **Any such far reaching change should be debated by Congress. ICBA supports statutory closure of the ILC loophole.**
- **ICBA urges Congress and the FDIC to impose an immediate moratorium on the approval of deposit insurance for ILCs.**

Banks hold a unique place in the American economy. Banking is not simply a business among other businesses. As neutral arbiters of commercial and consumer credit, bank independence from commercial activities is essential to their ability to assess risk and create fair access to credit based on the power of an idea, the track record of management, the current marketplace, and economic potential. That critical role would be jeopardized if commercial firms were allowed to own or control banks or their functional equivalents.

The longstanding American policy of separation of banking and commerce, as embodied in the Bank Holding Company Act (BHCA), must not be compromised or eroded. To preserve the character and safety of our economy and to uphold consumer and business confidence in our banks, commercial companies must not be allowed to own banks or bank-like institutions.

In the new era of dominant “Superstar Firms,”[1] Big Data, social media and e-commerce conglomerates, artificial intelligence, and financial technology, we should be cautious before giving these companies yet more reach into the economic life of Americans. Mixing banking and commerce would give rise to a whole new dimension of risk, a threat to not only our prosperity and economic diversity but to consumer privacy, price manipulation through artificial intelligence, and fraud on a massive scale. Too-big-to-manage would take on a whole new meaning.

The industrial loan company (ILC) charter, a full-service banking charter, is a stalking horse for this potential shift in policy. A loophole exists in the Bank Holding Company Act that allows commercial companies to own FDIC-insured ILCs without Federal Reserve oversight of the holding company or limitations on non-banking activities. A moratorium on FDIC approval of new ILC deposit insurance applications, first imposed by the FDIC in 2006, then by Congress in 2010, expired in 2013. In 2020, the FDIC approved the ILC applications of Square Financial Services, Inc. and Nelnet Bank, the first new ILCs since 2006. Applications filed by GM Financial and Rakuten Bank America remain pending. All of these companies have holding companies and affiliates that engage in diverse, non-financial, commercial activities.

These companies chose to apply for Utah ILC charters and not commercial bank charters because their parent companies wish to retain their current commercial activities, further engage in new activities unrelated to banking, and avoid consolidated supervision by the Federal Reserve as a bank holding company.

ICBA urges Congress to pass an amendment to the Bank Holding Company Act of 1956 to permanently close the ILC loophole, just as Congress has closed past banking loopholes that threatened to undermine consolidated supervision and the separation of banking and commerce.

1 Irwin, Neil, “Are Superstar Firms and Amazon Effects Reshaping the Economy?” New York Times. August 25, 2018. https://www.nytimes.com/2018/08/25/upshot/big-corporations-influence-economy-central-bank.html “The biggest companies may be influencing things like inflation and wage growth, possibly at the expense of central bankers’ power to do so.”

Before approving additional applications, ICBA urges Congress and the FDIC to impose an immediate moratorium on the issuance of deposit insurance to ILCs. A moratorium would allow Congress and the FDIC to thoroughly and thoughtfully examine the evolution of the American financial services industry in recent years and to ensure that new charters will not pose a threat to the FDIC insurance fund and the federal safety net. Developments in the area of financial technology in particular warrant close study and assessment.

This white paper will explore the principle of separating banking and commerce, the Bank Holding Company Act, the foundation and transformation of the ILC charter, and the potential of this charter to fundamentally transform the character of American finance.

Part I: Preserve the Separation of Banking and Commerce

We have described ILCs as a stalking horse for the combination of banking and commerce. Let's take a closer look at their key characteristics.

What is an ILC?

ILCs are essentially commercial banks chartered in Utah and a handful of other states.[2] They enjoy all of the commercial and consumer lending powers of commercial banks. While they are state chartered, they are free to operate nationwide, and there is no ceiling on their asset size or cap on the number of ILC charters that may be issued. ILCs qualify for FDIC insurance because they meet the definition of "state bank" under the Federal Deposit Insurance Act: they are incorporated under the laws of a state and they accept deposits (not limited to demand deposits). However, they are exempt from the definition of "bank" under the BHCA as amended, which explicitly exempts ILCs provided they are (i) chartered by a state that chartered ILCs as of 1987; and (ii) they do not accept demand deposits; have assets of less than $100 million; or have experienced no change in control since 1987. (12 USC 1841(c)(2)(H))

This is the ILC loophole that allows what are functionally full-service, federally insured, commercial banks to be owned by commercial companies and to evade consolidated supervision. The only limitation on ILCs, that they cannot accept demand deposits, is easily circumvented by offering functionally equivalent negotiable order of withdrawal (NOW) accounts.[3]

2 In addition to Utah, Nevada, California, Hawaii, and Minnesota have ILCs. Sixteen of the 25 existing ILCs are chartered in Utah. All of the commercially owned ILCs are chartered in either Utah or Nevada. California has barred commercial ownership of ILCs.

3 "Demand deposits" are deposits that may be withdrawn at any time and do not require prior notice of withdrawal to be given to the depository institution. Though prohibited from offering demand deposits, ILCs are able to offer negotiable order of withdrawal (NOW) accounts, which are interest-bearing savings accounts on which drafts may be written. Because the deposit-taking institution reserves the legal right to require notice before funds may be withdrawn, NOW accounts technically do not constitute "demand deposits," but are the functional equivalent.

Later in this paper we explore the explosive growth of ILCs after the creation of the loophole in 1987.

Why separate banking and commerce

The separation of banking and commerce is a long-standing principle of American economic policy. It was first embodied in statute in the 1956 Bank Holding Company Act (the BHCA), which created a formal definition of a bank holding company, established consolidated supervision, and limited the activities of bank holding companies to those closely related to banking, effectively separating the business of banking from "pure" commercial activities. The Act also created loopholes, some of which have since been closed by Congress. As discussed later in this paper, the ILC loophole is a product of later amendments to the BHCA. Changes in the financial marketplace have made this loophole increasingly dangerous.

Concern about concentrations of economic power and in particular business combinations that would create economic leverage date back decades prior to the BHCA and are deeply rooted in American economic thought.

In response to the stock market crash of 1929 and the subsequent economic depression, the Glass-Steagall Act of 1933 prohibited banks from engaging in securities dealing and underwriting and affiliating with securities firms, though it did not prohibit the ownership of commercial banks by non-banking firms.

Nevertheless, concern about the use of holding companies to concentrate economic power and calls for congressional action rose during the 1930s. In 1938, President Franklin D. Roosevelt sent a special message to Congress urging the passage of legislation enhancing antitrust protections against undue concentration of economic power in the hands of private businesses, including bank holding companies. Roosevelt feared the anti-democratic effect of economic monopolies. "Close financial control, through interlocking spheres of influence over channels of investment, and through the use of financial devices like holding companies and strategic minority interests, creates close control of the business policies of enterprises which masquerade as independent units."[4] Roosevelt urged Congress to pass legislation that would have, among other restrictions, banned a holding company or any corporation or enterprise in which it is financially interested to borrow from or sell securities to a bank in which it holds stock.

4 Roosevelt, Franklin D. "Message to Congress on Curbing Monopolies." April 29, 1938. http://www.presidency.ucsb.edu/ws/?pid=15637 "Private enterprise is ceasing to be free enterprise and is becoming a cluster of private collectivisms: masking itself as a system of free enterprise after the American model, it is in fact becoming a concealed cartel system after the European model." In addition: "Interlocking financial controls have taken from American business much of its traditional virility, independence, adaptability and daring—without compensating advantages. They have not given the stability they promised."

The Bank Holding Company Act

In the 1940s and 1950s, diversified bank holding companies grew in number and size. The Transamerica Corporation was symbolic of this trend. In the early 1950s, Transamerica owned 46 banks, a large share of Bank of America, an insurance company, real estate and oil development firms, and a fish packing company. This is the historical context in which Congress considered the BHCA.

There were two objectives in the enactment of the BHCA: Prohibiting the mixing of banking and commerce; and preventing the use of holding companies to circumvent restrictions on interstate banking. The common theme was concentrations of economic power, across states and across industries.

Barriers to interstate banking were removed by Congress in 1994 with the enactment of the Riegle-Neal Interstate Banking Act. Today we live in an age of large, national banks. ICBA supports enhanced regulation of too-big-to-fail banks to ensure a balanced marketplace that serves all communities and to prevent such banks from leveraging taxpayer subsidies and putting the national economy at risk – again. However, we recognize that national banks play an important role in serving large national and global corporations and fulfilling other functions that require a large scale.

The second objective of the BHCA, separation of banking and commerce, is as important today as it was 60 years ago when the Act passed, and indeed takes a new, ominous aspect in the age of Big Data.

While bank holding companies existed prior to the BHCA, the 1956 Act redefined a bank holding company as any company that held a stake of 25 percent or more of the shares of two or more banks or had similar control of voting rights. Stake holding included outright ownership as well as control of or the ability to vote on shares. For the purposes of the law, a bank was defined as any institution that takes deposits and makes loans.

All BHCs are required to register with, and become subject to consolidated regulation and supervision by, the Federal Reserve. BHCs submit mandatory periodic reports to the Federal Reserve and are subject to its direct examination authority. The Federal Reserve has extensive enforcement powers over BHCs, which are subject to capital adequacy regulation and must serve as a "source of strength" to their bank subsidiaries.

In addition, the BHCA addressed the mixing of banking and commerce by restricting permissible activities and investments of BHCs to banking, managing or owning banks, and a limited set of activities determined to be "closely related to banking." The BHCA required all bank holding companies to divest themselves of ownership in any firms that were involved in nonbank activities, i.e., commercial and industrial businesses.

The basic framework of the BHCA has endured for more than 60 years, though it has been updated through amendments to reflect the evolution of the American financial marketplace. “Gradually … the key policy focus of the BHCA regime began to shift toward defining the legal scope of permissible banking and “closely related to banking” activities.”[5]

Amendments to the BHCA: Reaffirming the separation of banking and commerce

Since passage of the BHCA, Congress has taken steps to reaffirm the separation of banking and commerce, close loopholes in the definition of a bank, and inadvertently open new loopholes that, as industry has evolved, have posed serious threats to the U.S. economy. A brief review of the history will help explain how we got where we are today and clarify the need to close the ILC loophole.

The first amendments to the BHCA were in 1966 when Congress narrowed the scope of the Act by redefining “bank” to refer only to institutions that accepted demand deposits, or deposits that may be withdrawn at any time and do not require prior notice of withdrawal to be given to the depository institution. This created a loophole for commercial companies to own bank-like subsidiaries provided these subsidiaries did not accept demand deposits. In 1970, Congress amended the BHCA to close the single-bank holding company loophole. In the original BHCA, a bank holding company had to control two or more banks. Congress made this change following a dramatic rise in the number of single-bank holding companies. The 1970 amendments also opened a new loophole by defining a bank as an entity that both accepts demand deposits and makes commercial loans. In the years following the 1970 Amendments, a number of “non-bank banks” arose that either did not accept demand deposits or did not make commercial loans but otherwise functioned much like commercial banks. Household names such as Sears, J.C. Penny, Aetna, Merrill Lynch, and Gulf & Western acquired non-bank banks for a variety of purposes such as credit card lending and in-house payments processing.

Pressure from the Federal Reserve, the small business community, and financial market participants including ICBA and community banks, led to enactment of the Competitive Banking Equality Act (CEBA) in 1987. CEBA closed the “non-bank bank” loophole, though it grandfathered existing non-bank banks.

5 Omarova, Saule T. and Margaret, Tahyar E., "That Which We Call a Bank: Revisiting the History of Bank Holding Company Regulations in the United States" (2012). Cornell Law Faculty Publications. Paper 1012. http://scholarship.law.cornell.edu/facpub/1012

Significantly, CEBA also exempted from the definition of "bank" certain categories of financial institutions, including industrial loan corporations, credit card banks, limited purpose trust companies, credit unions, and savings associations (or thrifts). Why did Congress exempt these categories of institutions? "These institutions were viewed as relatively small local institutions with a specialized focus and limited range of activities, centering primarily on consumer financial services."[6] With the exception of thrifts, these exemptions remain in effect today.[7] However, credit card banks and trust companies remain limited purpose institutions, true to the spirit and intent of the CEBA exemptions. As explained below, ILCs have evolved since 1987 from focused and limited institutions to full-service commercial banks with almost no check on their powers.

Subsequent amendments to the BHCA, the Gramm-Leach-Bliley Act of 1999 and the Dodd-Frank Act of 2010, have reaffirmed the separation of banking and commerce. Congress has consistently acted to close loopholes in the Act and prevent the mixing of banking and commerce and has only allowed exceptions for limited, narrowly focused institutions.

It is time for Congress to revisit the BHCA and close the ILC loophole which threatens to undermine the BHCA and permit mixing of full-service banking and commerce.

Part II: Regulatory "Blind Spots": The ILC Loophole Is a Threat to Safety and Soundness

ILCs are a threat to safety and soundness primarily because their commercial owners are exempt from consolidated supervision.

Consolidated supervision

One of the two key provisions of the BHCA is consolidated supervision of the holding company and its affiliates as a group (the other is the separation of commercial activities from banking). According to the Federal Reserve's Bank Holding Company Supervision Manual: "Financial trouble in one part of an organization can spread rapidly to other parts of the organization; moreover, large BHCs increasingly operate and manage their businesses on an integrated basis across corporate boundaries. Risks that cross legal entities or that are managed on a consolidated basis cannot be monitored properly through supervision directed at any one of the legal entity subsidiaries within

6 Omarova and Tahyar. Page 185.

7 The Savings and Loan Holding Company Act, which is now defunct, ran parallel to the BHCA and imposed comparable activities restrictions on holding companies of more than one thrift. These restrictions did not apply to unitary thrift holding companies (holding only a single thrift). As a result, In the late 1990s, Ford Motor Company, Sears Roebuck and Company, ITT Corporation and Weyerhaeuser Company were among the many commercial companies that owned thrift institutions." (Omarova and Tahyar, p. 184-185) The unitary thrift loophole was closed by the Gramm-Leach-Bliley Act in 1999.

the overall organization."[8] This is the rationale for consolidated supervision of the parent company and its subsidiaries. Consolidated supervision "allows the Federal Reserve to understand the organization's structure, activities, resources, and risks, as well as to address financial, managerial, operational, or other deficiencies before they pose a danger to the BHC's subsidiary depository institutions."[9]

ILC holding companies not subject to consolidated supervision

Because ILCs are exempt from the BHCA, ILC parent companies are not subject to consolidated supervision. The FDIC, as regulator of the ILC subsidiary, does have limited authority to examine the commercial parent. However, this authority is not remotely comparable to the Federal Reserve's consolidated supervision of bank holding companies, savings and loan holding companies, and financial holding companies. According to the Government Accountability Office "Federal Reserve officials noted that no federal regulator was assigned to look at the health of the entire holding company for an exempt institution… creating a potential regulatory 'blind spot.'"[10] The FDIC's authority to examine the commercial parent is limited to what affects the ILC. The FDIC would need a complete picture of the commercial parent, its risk management practices, and its capital standards in order to ensure commercial ownership does not threaten the federal safety net.

Holding company source of strength doctrine is of limited value without consolidated supervision of commercial parent companies

Under U.S. banking law, the parent company of an insured depository institution is expected to serve as a "source of financial strength" to its subsidiary. This means that the parent company must have the ability to inject cash into a struggling bank under its control. Conversely, regulators must ensure that if the parent company experiences difficulties, it will not drain the bank's liquidity in order to prop itself up. A subsidiary bank must not be a source of strength to its holding company. Holding companies are created to strengthen safety and soundness, not weaken it. This doctrine has been in effect for bank holding companies for several decades. It was formalized in the Dodd-Frank Act and extended to thrift holding companies and to non-financial parents of insured depositories, including ILCs.

However, without consolidated supervision, regulators cannot effectively enforce the source of strength doctrine for commercial ILC holding companies. The FDIC's authority to examine an ILC parent is limited to

8 "Bank Holding Company Supervision Manual." Federal Reserve Bank.

9 Ibid.

10 "Bank Holding Company Act: Characteristics and Regulation of Exempt Institutions and the Implications of Removing the Exemptions." Government Accountability Office. January 2012. Page 24.

aspects of its operations that affect the ILC.[11] Moreover, the FDIC has no authority to examine a non-financial affiliate of the holding company (a sibling affiliate of the ILC), but the failure of such an affiliate could stress the parent and impair its ability to serve as a source of strength for the ILC. Finally, holding companies of ILCs are not held to the same risk management and capital standards as bank holding companies.[12]

Current regulations govern transactions among affiliates, including quantitative limits, collateral requirements, consistency with safe and sound practices, and a requirement that transactions occur on market terms. However, without consolidated supervision of the holding company, these restrictions have limited value. Monitoring inter-affiliate transactions under a commercial holding company for conflicts of interest will strain the resources of the FDIC.

Even if ILC parents were subject to consolidated supervision, banking regulators do not have the knowledge or expertise to examine commercial holding companies whose governance functions, risk controls, financial operations and accounting practices are starkly different from those of a financial company. Imagine a bank examiner trying to assess the operations of a sprawling commercial conglomerate with multiple business lines in diverse industries or a digital behemoth such as Amazon, Google, or Facebook. These companies are reinventing traditional business models. It's fair to say that such an examiner would be out of their depth.

Risk to the federal safety net

In 2017, then Acting Comptroller of the Currency Keith Noreika suggested that the historic policy of separating banking and commerce should be revisited in the name of corporate diversification. "It's not the best thing to put all your eggs in one basket," as he put it.[13] This sounds sensible enough. In a diversified portfolio, losses in one investment are offset by gains in another. Noreika suggests that a holding company should comprise many baskets – or affiliates – to protect itself from overall losses. But should a federally insured banking affiliate prop up losses in a commercial affiliate? This is not the defined purpose of federal deposit insurance. Moreover, consolidation would create fewer, larger, conglomerate baskets, and each one would be "too-big-to-fail" because of the economic harm that would result due to its increased systemic importance.[14] These conglomerates,

11 Government Accountability Office.

12 Ibid.

13 Reported by Clozel, Lalita. "OCC Takes First Step Toward Rolling Back Volcker Rule." The American Banker. July 19, 2017. https://www.americanbanker.com/news/occ-to-take-first-step-toward-rolling-back-volcker-rule

14 Wilmarth. "Beware the Return of the ILC." "Creditors will expect that large banking-industrial conglomerates will benefit from "too big to fail" treatment during the next financial crisis, as GE and GMAC did last time." https://www.americanbanker.com/

being too-big-to-fail, would be able to finance themselves at below market rates because of the perception that the government would bail them out if they were at risk of failure. Subsidized borrowing would only increase their dominance in the marketplace, perpetuating a cycle of private gains and socialized losses.

Part III: Growth of the ILC Industry

At the time that Congress created the ILC loophole in 1987, ILCs were very small institutions and operated with limited powers. Their primary business was making small loans to industrial workers. The largest ILC had assets of $410 million and the average ILC had assets of $45 million. In 1987, states were not actively chartering new ILCs and Utah had imposed a moratorium on new charters. What's more, there were restrictions on interstate banks that effectively blocked the expansion of ILCs. Congress could not have envisioned the expanding scope of ILCs that would occur in the ensuing decades.

National financial and economic policy should not be driven by a single state

In 1997, Utah lifted its moratorium on the chartering of new ILCs, allowed ILCs to call themselves 'banks,' and permitted them to exercise virtually all of the powers of state-chartered commercial banks. Utah, and to a lesser extent Nevada, began to actively charter new ILCs and promote ILCs as a method for companies to acquire a bank while avoiding the requirements of the BHCA. As noted above, Congress closed the unitary thrift loophole in 1999. Because of this, commercial firms shifted their focus to the ILC as the last available method of acquiring banking powers.[15] Utah is overwhelmingly the source of these new ILC charters.

Since 1997, there has been a dramatic expansion in the number and size of ILCs. Between 1997 and 2006 the number of ILC charters doubled to 56. Total ILC assets grew from $25.1 billion to $212.8 billion. The largest ILC was $60 billion, dwarfing the size of the average community bank which has assets of $200 million. There were six ILCs with assets over $10 billion, and 12 with assets of more than $1 billion. ILCs were owned by prominent companies such as Toyota, Merrill Lynch, and Goldman Sachs.

Since the 2006 FDIC moratorium and the subsequent financial crisis which led some of the ILC parents to become financial holding companies, the

opinion/beware-the-return-of-the-ilc

15 Alvarez, Scott G., Testimony before the Senate Committee on Banking, Housing, and Urban Affairs. October 4, 2007.

number of ILCs has dropped to 25 today and total ILC assets now stand at $196.6 billion, as of September 30, 2021.

A loophole in the Bank Holding Company Act, paired with the aggressive marketing of the ILC charter by one state seeking relevance in the banking industry, should not be allowed to remake the national financial services landscape. The FDIC should reimpose its moratorium on deposit insurance applications for ILCs, and Congress – not an ambitious state – should debate commercial ownership of financial institutions.

Walmart ILC application and the FDIC/Dodd Frank Act moratoria

In 2006, eight ILC deposit insurance applications were pending before the FDIC and an additional three had been withdrawn or returned. In addition, seven notices of change in bank control to acquire an ILC were submitted that year of which five were withdrawn. None of the parent companies would have been subject to consolidated supervision. Nine of the 18 potential parent companies were commercial. Applicants included mega-retailers such as Walmart and Home Depot, auto companies Ford and Daimler Chrysler, and private equity firm J.C. Flowers. The Walmart application in particular generated significant controversy among the public, industry, and members of Congress.[16]

The FDIC was right to act as it did in imposing a moratorium when faced with the prospect of an irreversible transformation of the American financial services landscape and concern about the consequences for safety and soundness and for the character of the American commercial life. To date, the concerns that led to the moratorium in 2006 remain unresolved. In fact, as described below, there is more cause for concern today than there was at that time.

If commercial holding companies are allowed to enter banking through the acquisition of ILCs, any remaining barriers to combining banking and commerce will completely erode. The financial landscape could be transformed in a very short period of time.[17] We can only imagine how common ownership of banking and commercial firms could have amplified bank failures and catastrophic losses to communities and consumers following the 2007-2009 recession.

16 Federal Deposit Insurance Corporation. “Moratorium on Certain Industrial Loan Company Applications and Notices.” Federal Register, August 1, 2006. “The FDIC also received more than 13,000 comment letters and heard substantial testimony in three days of hearings on the proposed Wal-Mart Bank’s deposit insurance application. Most of the comments and testimony expressed opposition to the granting of deposit insurance to this particular applicant… over 640 of those comments specifically raised concerns over the risk to the deposit insurance fund posed by an ILC that has a parent without a consolidated Federal supervisor or in which an ILC is owned or affiliated with a commercial concern.” Congressional hearings were held and bills were introduced affecting ILCs.

17 Alvarez.

Part IV: ILCs a Path to More Corporate Consolidation and Concentration of Power

The barrier which has existed between banking and commerce since 1956 serves to disperse economic power. Consolidation is occurring in the commercial, non-financial sector and, separately, in the banking and financial sector at a rapid pace. The effects of consolidation are not well understood. Economists are beginning to study the linkages between an economy with industries dominated by a small number of mega-firms and sluggish growth in wages, inflation, and corporate investment.[18]

But the scale of consolidation is kept in check by the barrier between banking and commerce. Lifting this barrier would only promote rampant consolidation across industries, creating mega-firms at a yet larger scale. In an era of “Superstar Firms” do we want to give them yet more reach into the economic life of America?

Credit allocation and market distortion

In addition to the safety and soundness concerns outlined above, consolidation of corporate-banking combinations would inhibit impartial credit allocation. An ILC subsidiary of a commercial company would not function as an independent credit provider. The commercial parent company could deter the bank subsidiary from lending to a competitor of the parent, even though the competitor may be a good loan prospect. The bank subsidiary might restrict lending to customers or suppliers of the parent or only offer favorable terms to these entities. If the competitor cannot obtain a loan on favorable terms, it might decide to acquire its own bank subsidiary to remain competitive by funding itself though FDIC-insured deposits. Thus, competitive pressures could cause a small number of commercial parent-bank subsidiary combinations to quickly escalate, resulting in an entire commercial sector funded by FDIC-insured deposits. Those commercial corporations that don’t have the resources to charter or acquire an ILC to remain competitive, will themselves be acquired. This will promote consolidation.[19]

If this is allowed to occur as a result of the ILC loophole, businesses that should have access to credit based on the value of their ideas and the economic promise they hold, will struggle to obtain credit. The concentration of economic power would change the character of commercial life. Something vitally important is lost when the credit function is subordinate

18 Irwin.

19 Wilmarth, Arthur E. “Beware the Return of the ILC.” The American Banker. August 2, 2017. “Banking-industrial combinations would also create unfair competitive advantages for large commercial and industrial firms that can afford the costs of acquiring and operating banks. FDIC-insured deposits are the cheapest source of private-sector funding available.”

to commercial conglomerates, what Roosevelt called the “traditional virility, independence, adaptability and daring” of American business.[20]

Are we ready for an “Age of Mega-Conglomerates”?

In the 1950s, as previously noted, TransAmerica alarmed the American public and policymakers as an example of the unchecked power of conglomeration. Imagine a new breed of mega-conglomerates with tentacles into technology, retail sales, various business and consumer services, as well as commercial and investment banking, insurance, investment advisory and management, and more. What kind of economic and political power would such conglomerates hold over the lives of ordinary Americans? We don’t have to go as far as President Franklin Roosevelt in comparing concentrated economic power to fascism to believe that such power carries the potential for grave abuse.[21]

Consumers and workers would be vulnerable to price and wage manipulation. Are our anti-trust laws robust enough to keep super-conglomerates in check? The dominance of such firms would be especially harmful for the thousands of small and rural communities which are currently served by a diversity of small businesses and community banks.

In a digital economy, the ILC charter carries new risks

There are thousands of U.S. fintech firms deeply involved in non-financial commercial activities. Many of these would no doubt welcome the opportunity to obtain an ILC charter with deposit insurance in order to obtain low-cost deposit funding while retaining and expanding their commercial ventures.[22]

The integration of these technology and banking firms would not only result in an enormous concentration of financial and technological assets but also would pose conflicts of interest and privacy concerns to our banking system. With Square and Nelnet Bank becoming ILCs, we believe it is only a matter of time before large technology firms like Google, Amazon, Facebook, Apple, or Microsoft apply for an ILC charter.

What will happen when social media giants extend their reach into our financial lives? Big Data tracks our movements, our friends, families, and associates, our religious and political affiliations and views, our internet

20 See supra note 4.

21 Roosevelt. “The first truth is that the liberty of a democracy is not safe if the people tolerate the growth of private power to a point where it becomes stronger than their democratic state itself. That, in its essence, is Fascism—ownership of Government by an individual, by a group, or by any other controlling private power.”

22 See, for example, Witkowski, Rachel. “Are Fintechs Better Off Taking the ILC Route to Banking.” The American Banker. January 22, 2019. “Growing uncertainty about a new federal charter offered by the Office of the Comptroller of the Currency is magnifying a different option for fintech firms seeking a way into the banking sphere: the industrial loan company.”

browsing and shopping history. This data is already used (some would say abused) for marketing products and services and for targeted political messages – sometimes by nefarious actors. Adding personal, financial data -- monthly paycheck direct deposits, account balances, expense patterns, political contributions, history of late fees, transaction records, etc. -- would take targeted marketing to a whole new level. Moreover, this financial data could be sold to third party data aggregators.

An end to neutral financial product offerings?

This data could be used to discriminate in lending and other financial services. Will your credit or insurance offerings be based on your social profile? What about your lifestyle, travel, shopping habits, and friends? The opinions you post and even the opinions your friends post, parsed finely enough and filtered through an algorithm, may correlate with your credit risk or your likelihood of filing an insurance claim.

Consider the potential for price discrimination even for non-financial products. As Karen Shaw Petrou has observed: "One specific danger of a company like Amazon getting into finance is the possibility of analytics-based price manipulation. A consumer might try to buy a pair of sneakers and be offered a more expensive pair of sneakers because Amazon knows how much money he or she has… It's watching your payment speed, estimating your pain threshold, and all of a sudden prioritizing products based on what it thinks it knows about what you can afford."[23]

We believe this would be a step well beyond the comfort zone of most Americans. Dominant social media-commercial-financial mega-firms would have unprecedented reach into our private lives. Such a change should not be made without careful deliberation by the FDIC and by Congress.

23 Shaw Petrou, Karen. "Making 'Responsible Innovation' a Reality: Big Tech, Small Money, and U.S. Economic Equality." Federal Financial Analytics. February 4, 2019. See also: Smith, Noah. "Artificial Intelligence Still Isn't All That Smart." Bloomberg Opinion. August 16, 2018. https://www.bloomberg.com/view/articles/2018-08-16/smart-machines-won-t-be-ready-to-do-complex-jobs-anytime-soon. "Machine learning-enabled price discrimination might allow companies to figure out exactly how much customers are willing to pay for things and gouge them for every penny."

Closing

Before we give up our last vestige of privacy and lurch into a new era of corporate saturation, let's hit the pause button and engage in an informed debate about the future financial and economic life of our country. The FDIC's approval of new ILC deposit insurance applications again, such as with Square or Nelnet or those pending from GM or Rakuten, undoubtedly will continue to encourage a great number of additional, commercial applicants. Such a precedent would be hard to reverse, and a slew of new commercially owned ILCs could change the financial landscape in a few short years.

Since the 1956 BHCA, Congress has consistently reaffirmed the separation of banking and commerce and the importance of holding company supervision. As described above, Congress closed the unitary thrift holding company loophole in 1999 and closed the nonbank bank loophole in 1987. Congress has only allowed exceptions that were extremely limited in scope, as was the ILC loophole when it was created. The ILC is a threat to the Bank Holding Company Act, to the safety and soundness of the U.S. financial system, and at the leading edge of an economic transformation Americans may not be ready for. Congress should now close the ILC loophole to prevent the unraveling of the BHCA.

ABOUT

ICBA

The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services.

With nearly 50,000 locations nationwide, community banks constitute roughly 99 percent of all banks, employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding nearly $5.9 trillion in assets, over $4.9 trillion in deposits, and more than $3.5 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at **www.icba.org**.

CONTINUE THE CONVERSATION

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