AFR Americans for Financial Reform

Federal Deposit Insurance Corporation
San Francisco Regional Office
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San Francisco, CA 94105
Submitted at www.fdic.gov/regulations/cra/

Re: **20170820 - SoFi Bank - Deposit Insurance (New Bank)**

To Whom it May Concern:

Americans for Financial Reform ("AFR") appreciates the opportunity to comment on Social Finance, Inc.'s ("SoFi") application to open an FDIC-insured industrial loan company ("ILC"). AFR is a coalition of over 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups.[1] AFR opposes SoFi's application and urges FDIC to deny it.

ILC charters exploit a loophole in federal banking laws to gain access to the federal deposit-insurance safety net while avoiding critical federal supervision and regulation. ILCs therefore pose unique risks to the financial system. If its application is granted, SoFi will be the first new ILC to secure deposit insurance in over a decade. That will send a clear signal to the marketplace that the FDIC intends once again to approve ILC deposit insurance applications. FDIC should not grant SoFi's application and allow the ILC loophole to be revived.

The risk and supervision issues presented by ILCs are such that the Federal Reserve has recently recommended that Congress act to repeal the exemptions that allow ILCs to operate outside of the supervisory controls applicable to other banks.[2] Unless and until this recommendation is followed, further ILCs should not be chartered. Certainly the FDIC should not insure an ILC owned by an institution such as SoFi, which is a highly sophisticated financial institution seeking to gain access to the bank safety net through a mechanism that allows it to avoid standard supervision of bank holding companies.

AFR also notes that SoFi's Community Reinvestment Act plan is woefully inadequate to justify approval of its application. In particular, its plan proposes to serve low- and moderate-income consumers with only substandard products and its proposed assessment area does not mirror the areas in which it conducts the bulk of its business. We understand other public interest commenters will address these concerns in detail.

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[1] A complete list of AFR's coalition members is available at http://ourfinancialsecurity.org/about/our-coalition/.

[2] Board of Governors of the Federal Reserve et. al., Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act, Sept. 2016, available at https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160908a1.pdf.

The ILC Loophole Undermines the Longstanding Separation between Banking and Commerce

Congress has sought to keep banking and commerce separate for decades and has previously closed loopholes that would weaken the barrier between the two, most notably in 1987 and 1999. The Competitive Equality Banking Act of 1987 ("CEBA") expanded the definition of "bank" under the Bank Holding Company Act ("BHCA") to include a number of institutions referred to as "non-bank banks." These non-bank banks had been an attractive option for commercial firms looking to operate FDIC-insured depositary institutions without having to comply with the BHCA's restrictions. In passing the CEBA, Congress reaffirmed that the separation of banking and commerce is a "'keystone'" of the banking system and that the elimination of non-bank banks would strengthen "'the safety and soundness of our financial system.'"[3] In 1999, the Gramm-Leach-Bliley Act ("GLBA") closed the remaining unitary thrift loophole which allowed commercial firms to own and operate a single thrift.

Despite the active effort to stop such end-runs around well-established banking policy, legislators carved out an exception in the CEBA for ILCs. As a result, aggregate assets at ILCs increased nearly thirtyfold between 1987 and 2006, the year Wal-Mart applied for an ILC charter.[4] By then, several large commercial firms including Target Corp., General Electric, and General Motors were already operating ILCs.

However, the FDIC did not approve Wal-Mart's application for deposit insurance. Instead, the FDIC issued a one-year moratorium on ILC charters for commercial firms. The moratorium was extended for an additional year so Congress would have an opportunity to craft a legislative response to the issue.[5] Although the moratorium has since expired without any action by Congress, until now the FDIC had not received deposit insurance applications from a newly-chartered ILC, commercial or otherwise.

The Financial Crisis Demonstrates that ILCs Pose Significant Risks to the Financial System

Prior to the 2008 financial crisis, the seven largest ILCs were among the 125 largest FDIC-insured depositary institutions.[6] One, GMAC, the financial arm of General Motors, was owned by a commercial firm.

GMAC began life as a straightforward auto-financing operation but by 2008 had become involved in issuing subprime mortgage-backed securities. As the subprime mortgage crisis

[3] Arthur E. Wilmarth Jr., *Wal-Mart and the Separation of Banking and Commerce,* 39 CONN. L REV. 1539, 1570-71 (2007) (quoting the Senate Committee Report on CEBA).

[4] Christian Johnson & George G. Kaufman, *When a Bank is Not a Bank: The Case of Industrial Loan Companies* 9, *in* Financial Institutions and Markets: Current Issues in Financial Markets, eds. Robert R. Bliss & George G. Kaufman (2008).

[5] Id. at 14 (noting a statement by then-FDIC Chair Sheila Bair).

[6] Id. at 9.

unfolded, GMAC and its parent company found themselves exposed to massive losses.[7] As the primary provider of floorplan financing to GM and Chrysler dealerships, GMAC's failure could have certainly meant a total collapse of the domestic auto industry.[8] To avoid bankruptcy and save the automakers, the only option was for GMAC to convert to a Bank Holding Company ("BHC") so it could qualify for federal aid.[9] It took $17.2 billion in three rounds of bailout payments to save GMAC. By 2010, the federal government owned over seventy percent of GMAC which had rebranded itself as Ally Bank.[10]

The GMAC failure and subsequent bailout was a manifestation of the many unregulated risks created by ILCs. During the 2006 debate surrounding Wal-Mart's ILC charter application, a number of commenters noted that allowing banking and commerce to comingle could lead to an unprecedented extension of the federal safety net to commercial firms.[11] And so it did. The rescue of GMAC remains widely viewed as a backdoor bailout of GM and Chrysler.

Significant safety-and-soundness -- and even systemic -- risks can be created by non-commercial ownership of ILCs as well. In 2008, the four largest securities firms at that time – Goldman Sachs, Morgan Stanley, Merrill Lynch, and Lehman Brothers – each operated a Utah ILC. Only two of those firms survive independently today, while none of the ILCs do. Each firm sought to take advantage of the FDIC-insured deposit accounts at their ILCs to fund their lending operations.[12] While the securities firms' crises remained relatively quarantined from their ILC operations, it is not difficult to imagine reciprocal contagion between financial firms and their ILCs in the future that could put the Deposit Insurance Fund and the safety and soundness of the financial system in jeopardy. To prevent such unacceptable risks from occurring, ILC parents should not be allowed to escape the rules applied to BHCs. Goldman Sachs and Morgan Stanley have since converted to BHCs and converted their ILCs to banks.[13]

SoFi and its Stakeholders Should be Regulated as Bank Holding Companies

SoFi Bank may potentially pose the same risks as both commercially- and financially-owned ILCs. For one, SoFi is itself owned in large part by private equity firms SoftBank and Renren.

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[7] Saule T. Omarova, *From Gramm-Leach-Bliley to Dodd-Frank: The Unfulfilled Promise of Section 23A of the Federal Reserve Act*, 89 N.C. L. Rev. 101, 169-70 (2010).

[8] Special Inspector General for the Troubled Asset Relief Program, Taxpayers Continue to Own 74% of GMAC (rebranded as Ally Financial Inc.) from the TARP Bailouts, Jan. 2013, available at https://www.sigtarp.gov/Audit%20Reports/Taxpayers_GMAC.pdf#page=3.

[9] Omarova, *supra* note 7, at 170.

[10] Special Inspector General for the Troubled Asset Relief Program, *supra* note 8, at 10.

[11] *See, e.g.,* Wilmarth, *supra* note 3, at 1589.

[12] Arthur E. Wilmarth Jr., *Subprime Crisis Confirms Wisdom of Separating Banking and Commerce*, 25 Banking & Fin. Services Pol'y Rep. 1, 7 (2008) (discussing how Merrill Lynch used its ILC).

[13] Alston & Bird LLP, Financial crisis drives remaining independent investment banks to Federal Reserve regulation, Sept. 2008, available at http://www.lexology.com/library/detail.aspx?g=8a1ff934-7a79-4ba7-95dd-4cf984f2cbc7.

According to SoFi's application, each of these companies owns a 10% or larger stake in SoFi.[14] SEC filings show that Renren owns around 20% of SoFi; SoftBank's share is likely even larger.[15] Without the ILC loophole, SoftBank, Renren, and possibly other private equity investors would be presumed to be BHCs and subject to consolidated supervision, the limitations of the BHCA, and all other applicable laws and regulations.[16]

As it stands, if SoFi's application is granted, SoFi and its parent companies will remain outside the established framework for BHCs. For instance, although ILCs are subject to the Community Reinvestment Act ("CRA"), ILC parents remain unaffected even if the subsidiary institution's CRA rating falls below satisfactory. In comparison, BHCs may be prevented from commencing new activities if they do not maintain satisfactory CRA ratings.[17] ILC parents are also immune from the GLBA's requirement that BHCs wishing to conduct non-banking financial activities maintain well-capitalized, well-managed, and CRA-compliant depositary subsidiaries.[18] There seems to be little reason for FDIC to grant a charter that would arbitrarily exempt SoFi, a financial company, and its investors from rules placed on functionally equivalent organizations.

ILC parent companies also appear to remain outside the scope of the Source of Strength Doctrine. Section 616(d) of the Dodd-Frank Act amended the Federal Deposit Insurance Act to require BHCs and Savings and Loan Holding Companies ("SLHCs") to act as sources of financial strength to their subsidiary depository institutions. But no mention is made of ILC parent companies; even the blanket clause meant to cover FDIC-insured depositary institutions not controlled by a BHC or SLHC does not appear to extend to ILC parent companies.[19] Even if Dodd-Frank § 616(d) does apply to ILCs and their parent companies, ILC parents are not subject to consolidated capital requirements;consequently, there is no certainty that ILC parents would be capable of serving as sources of financial strength to their subsidiary depository institutions. History has shown that the opposite is more likely to be true and that ILCs, with their access to the Deposit Insurance Fund, can come to serve as sources of financial strength for their parent institutions as in the case of GMAC.

The essence of SoFi's application is a request to seek the benefits of federal deposit insurance without subjecting SoFi itself or its private equity owners to the well-founded requirements for bank holding companies. The FDIC should not approve the application to facilitate this regulatory arbitrage.

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[14] SoFi, Interagency Charter and Federal Deposit Insurance Application, June 2017, available at https://tctechcrunch2011.files.wordpress.com/2017/06/sofi-fdic-application-redacted.pdf#page=36.

[15] Renren Inc., Form 20-F for the fiscal year ended Dec. 31, 2016, available at https://www.sec.gov/Archives/edgar/data/1509223/000114420417027564/v464327_20f.htm#a_004

[16] 12 U.S.C. § 1841.

[17] The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective, https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html.

[18] 12 U.S.C. § 1843(l).

[19] 12 U.S.C. § 1831o-1.

SoFi and its Parents Should be Subject to The Full Range of Regulation Imposed on Other Banks, Including Consolidated Supervision

Speaking in 2009, then-Federal Reserve chair Ben Bernanke summarized a key lesson of the 2008 financial crisis for bank supervision:

> First, recent experience confirms the value of supervision of financial holding companies--especially the largest, most complex, and systemically critical institutions--on a consolidated basis, supplementing the supervision that takes place at the level of the holding company's subsidiaries. Large financial institutions manage their businesses in an integrated manner with little regard for the corporate or national boundaries that define the jurisdictions of functional supervisors in the United States and abroad…. Because financial, operational, and reputational linkages span large and complex financial firms, the risks borne by such firms cannot be adequately evaluated through supervision focused on individual subsidiaries alone. Instead, effective supervision must involve greater coordination among consolidated and functional supervisors and an integrated assessment of risks across the holding company and its subsidiaries.[20]

In response to the gaps in consolidated supervision permitted prior to the financial crisis, the Dodd-Frank Act granted the Federal Reserve enhanced powers for the consolidated supervision of bank holding companies. However, these powers are not fully applicable to ILCs.

The Federal Reserve itself has recently recommended that Congress take statutory action to bring ILCs within the framework of consolidated regulation.[21] In its report, the Federal Reserve stated:

> ILCs are state-chartered banks that have virtually all of the powers and privileges of other insured commercial banks, including the protections of the federal safety net: deposit insurance and access to the Federal Reserve’s discount window and payments system. Nonetheless, ILCs, as defined in the BHC Act, are not included within the definition of the term “bank” under the act. As a result, any type of firm, including a commercial firm or foreign bank, may acquire and operate an ILC without complying with the standards that Congress has established for BHCs to maintain the separation of banking and commerce and to protect insured banks, the federal safety net and, ultimately, the taxpayer…. [T]he exemptions foster an unfair and uneven competitive and regulatory playing field by allowing GUSLHCs and corporate owners of ILCs to operate outside the activity restrictions (and in the case of corporate owners of ILCs, the consolidated supervisory and regulatory framework) that apply to other community-based, regional, and diversified organizations that own a similarly situated bank.[22]

[20] Speech of Ben Bernanke, Oct. 2009, available at https://www.federalreserve.gov/newsevents/speech/bernanke20091023a.htm.

[21] Board of Governors of the Federal Reserve, *supra* note 2.

[22] Id.

As this passage emphasizes, permitting ILCs to operate free of consolidated supervision and relevant activity restrictions that govern other insured banks creates an imbalanced competitive playing field and also threatens the integrity of the Federal safety net for banks, creating a threat to the taxpayer. This is likely to be particularly true in the case of SoFi, which is an aggressive, sophisticated, and fast-growing financial institution at the cutting edge of online lending markets.

It is highly inappropriate to bring this type of institution into the core of the federal safety net through a mechanism that simultaneously exempts it from central elements of banking regulation. Yet this is exactly what would be done by granting SoFi deposit insurance through the use of the ILC framework.

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Respectfully submitted,

Americans for Financial Reform