July 1, 2020

The Honorable Jelena McWilliams
Chair
Federal Deposit Insurance Corporation
11776 F. Street N.W.
Washington, DC 20006
comments@fdic.gov

RE: FDIC Docket RIN 3064-AF31 – Notice of Proposed Rulemaking: "Parent Companies of Industrial Banks and Industrial Loan Companies," 85 Fed. Reg. 17771 (Mar. 31, 2020).

Dear Chair McWilliams:

The Americans for Financial Reform Education Fund (AFR Education Fund) and Demand Progress Education Fund (DPEF) appreciate the opportunity to comment on the above Proposed Rule by the Federal Deposit Insurance Corporation (FDIC), as well as the agency's approval of new charters for insured industrial banks and industrial loan companies (hereinafter collectively referred to as "ILCs"). AFR Education Fund is a coalition of more than 200 national, state, and local groups who have come together to advocate for reform of the financial industry. Members of AFR Education Fund include consumer, civil rights, investor, retiree, community, labor, faith based, and business groups. DPEF is a fiscally-sponsored project of New Venture Fund, a 501(c)3 organization. DPEF and our more than two million affiliated activists seek to protect the democratic character of the internet — and wield it to make government accountable and contest concentrated corporate power.

We write to express our concern with the Proposed Rule to establish terms and conditions governing deposit insurance applications, changes in control, and mergers involving ILCs.[1] If adopted, the Proposed Rule would threaten state-level consumer protections, further erode the traditional separation between banking and commerce, and jeopardize the safety and soundness of the financial system and the economy as a whole. We are especially concerned that the

[1] *See* FDIC Docket RIN 3064-AF31, 85 Fed. Reg. 17771 (Mar. 31, 2020), https://www.fdic.gov/news/press-releases/2020/pr20031a.pdf [hereinafter "Proposed Rule"].

Proposed Rule would result in unhealthy combinations between data collection and finance firms, which would "magnify the excessive levels of concentration, the 'too big to fail' subsidies, and the unhealthy political influence that our technology giants and megabanks already enjoy and exploit."[2]

ILCs preempt important consumer protections and other state laws that must be defended, especially during times of economic and social distress. Under the Proposed Rule, the FDIC would open the floodgates to the acquisition of ILCs by nonfinancial firms, including commercial businesses that depend on customer and business partner surveillance methods that have no place in our regulated banking system and should not be attached to the federal safety net. Overall, any companies acting as banks — regardless of the financial or nonfinancial nature of their parent companies — should be regulated as banks, under consolidated supervision. Companies acting as bank holding companies should be regulated as bank holding companies. We repeat the previous calls by the Federal Reserve Board of Governors (Board) to close the ILC loophole.

ILCs Expand Federal Pre-Emption And Endanger Consumers

As a fundamental matter, we oppose the grant of ILC charters because they allow companies that would otherwise be subject to state-by-state consumer regulations to avoid them and invoke the laws of the few lightly regulated states that charter ILCs, such as Utah.[3] This is an especially unwise time to allow corporate lenders to skirt usury caps and other bright-line safeguards.[4] As Sen. Brown has stated, now is the time "focus on the families that depend on the

[2] Comment from Arthur E. Wilmarth, Jr., Prof. of Law, Geo. Wash. Univ. L. Sch., to FDIC (Apr. 10, 2020), https://www.fdic.gov/regulations/laws/federal/2020/2020-parent-companies-of-industrial-banks-3064-af31-c-002.pdf [hereinafter "Wilmarth Comment"].
[3] Of the 25 existing ILCs (including Square and Nelnet), 16 are chartered in Utah and four are chartered in Nevada. However, other states are now actively exploring ILC Charters. *See, e.g.,* Brendan Peterson, *Are states gaining upper hand in fintech charter battle?*, Am. Banker (Dec. 30, 2019), https://www.americanbanker.com/news/are-states-gaining-upper-hand-in-fintech-charter-battle?position. *But see also* 12 U.S.C. § 1841(c)(2)(H)(i) (only ILCs organized under the laws of a state which permitted such an entity on March 5, 1987 are excepted from the BHCA definition of 'bank", arguably limiting this option to only those states with a similar statute in effect or under consideration in the state legislature by March 5, 1987). *See also* Letter from Nat'l Consumer L. Ctr. et al. to OCC (Sept. 2, 2014), https://ourfinancialsecurity.org/wp-content/uploads/2014/09/OCC-10-year-review-comments-consumer-groups.pdf (arguing the OCC's final rules ignore the mandate of Congress and give national banks immunity from state laws protecting consumers from abusive practices in areas including mortgages, credit cards, overdraft fees and other areas).
[4] Press Release, Sen. Sherrod Brown, Brown, Van Hollen Announce Legislation to Cap Consumer Lending Rates During COVID-19 Outbreak, (Mar. 22, 2020), https://www.banking.senate.gov/newsroom/minority/icymi-brown-van-hollen-announce-legislation-to-cap-consumer-lending-rates-during-covid-19-outbreak ("The exorbitant fees charged by payday lenders are abhorrent, even under normal circumstances – but in an emergency, these fees should be criminal. Loan sharks should not be able to profit on those who are struggling to get by, due to the impacts of the coronavirus. We should immediately cap consumer lending rates to ensure fairer lending practices across the country," said Senator Van Hollen).

banking system", not "shuffle corporate favors through the side door while we're dealing with a pandemic."[5] American families are continuing to struggle with the ongoing economic fallout from COVID-19 and in need of greater relief. We consider the preemption of state usury caps to be especially concerning. Twenty states and the District of Columbia cap the APR for a $500 six-month loan at 36% or less.[6] It is more important than ever that we preserve states' ability to protect consumers from predatory lenders and other abusive practices.

We echo the fair lending and consumer protection concerns of our fellow commentators, especially given the history of ILC owners and ILCs engaging in predatory lending.[7] We underscore specific concerns regarding the applications of financial technology or *fintech* companies that use newer underwriting techniques and other tools that have been criticized for their disparate impact.[8] In general, many of these longer-term alternative loans typically carry extremely high interest rates and are made with little regard for the borrower's ability to repay the loan while meeting other expenses. Due to the history of lending discrimination, lack of access to traditional banking services, lower wages, and higher poverty rates, communities of color are often disproportionately harmed by high-cost loans. Fintech companies often target the low and moderate income families outside the traditional banking system with new financial products that often come with problematic terms and unaffordable interest rates that violate state laws. They should not be permitted the preemptive privileges that come with an ILC charter that allow them to disregard consumer protections that states have put in place to protect their residents.

We have already seen evidence that companies applying for ILCs are not taking fair lending concerns seriously. In February 2019, a number of community groups wrote to the FDIC urging it to reject Square's application based on its proposed plan to comply with the Community

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[5] *See* Press Release, Sen. Sherrod Brown, Brown Blasts FDIC For Approving New Industrial Bank Charters During Coronavirus Pandemic, (Mar. 18, 2020), https://www.brown.senate.gov/newsroom/press/release/brown-blasts-fdic-for-approving-new-industrial-bank-charters-during-coronavirus-pandemic.

[6] NATIONAL CONSUMER LAW CENTER, PREDATORY INSTALLMENT LENDING IN THE STATES: 2020 3 (Feb. 2020) https://www.nclc.org/images/pdf/rpt-InstallmentLoans-feb-2020.pdf.

[7] *See*, Wilmarth Comment *supra* note 2, at 6-9 (discussing the predatory subprime lending practices of ILCs Pacific Thrift and Loan, Southern Pacific Bank, Fremont General, GMAC, Merrill Lynch, and GE Capital).

[8] *See, e.g.*, *Banking on Your Data: The Role of Big Data in Financial Services: Hearing Before the H. Comm. on Fin. Services*, 116th Cong. 16-20 (2019) (Statement of Lauren Saunders, Assoc. Dir., Nat'l Consumer Law Center), *available at* https://www.nclc.org/images/pdf/cons-protection/testimony-lauren-saunders-data-aggregator-nov2019.pdf (discussing fintech and the Equal Credit Opportunity Act); *Banking on Your Data: The Role of Big Data in Financial Services: Hearing Before the H. Comm. on Fin. Services*, 116th Cong. 3 (2019) (Statement of Dr. Seny Kamara, PhD), *available at* https://financialservices.house.gov/uploadedfiles/Hhrg-116-ba00-wstate-kamaras-20191121.pdf ("[Algorithmic bias] is a serious concern in the context of the Equal Credit Opportunity Act and the Fair Housing Act, both of which prohibit discriminatory lending practices")**;** Kristin Johnson et al., *Artificial Intelligence, Machine Learning, and Bias in Finance: Toward Responsible Innovation*, 88 FORDHAM L. REV. 499, 505, 517–21 (2019) (arguing fintech firms may "hardwire predatory inclusion" into financial markets for the "next several generations").

Reinvestment Act (CRA).[9] AFR has opposed similar proposals, for instance arguing that the CRA plan offered by fintech lender Social Finance (SoFi) was woefully inadequate to justify approval of its application, and in fact, baldly proposed serving low-and-middle income (LMI) consumers with only substandard products.[10] Similarly, per its recently filed application, e-commerce giant Rakuten would engage in retail lending nationwide, but has previously refused states it does not want to be evaluated regarding whether its retail activity is serving LMI consumers and communities.[11]

In some ways, this general scenario should be expected. When the ILC exemption was adopted in 1987, ILCs were small, locally-focused institutions that offered deposit and credit services to LMI consumers.[12] But decades of abuse of the loophole have changed the character of applicant companies. Although it may not have not have been the intention of the ILC regime architects,[13] today, the companies that stand to take advantage of exportation doctrine are large multinational technology conglomerates constantly subject to criticism by consumer advocates. Congress should not be tying the hands of states that wish to protect their residents from under-regulated ILCs.

The approval of ILCs makes even less sense in the context of the COVID-19 pandemic. Two companies that have been approved for ILCs are cash-flow dependent businesses that pose unique threats to consumers and the federal safety net at this time. The first, Nelnet, is a student loan servicer.[14] Total student debt surpassed $1.6 trillion in this country before the onset of the pandemic, and student loan servicing abuses are well-documented.[15] A student loan servicer

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[9] *See generally* Letter to Regional Director Kathy Moe & Assistant Regional Director Perissa Ali Clark, FDIC San Francisco Regional Office, from California Reinvestment Coalition, at 1-2 (Feb. 19, 2019), http://src.bna.com/HVX [https://perma.cc/2EBZ-2JUZ] [Hereinafter CRC Letter].

[10] *See* Letter from Ams. for Fin. Reform to FDIC (July 19, 2017), https://ourfinancialsecurity.org/2017/07/letter-regulators-afr-opposes-sofis-deposit-insurance-application/ [hereinafter "AFR SoFi Letter"].

[11] *See* Letter from Nat'l Cmty. Reinvestment Coal. to FDIC (Aug. 27, 2019), https://ncrc.org/ncrc-comment-letter-on-rakuten-charter-application/.

[12] *See* Wilmarth Comment, *supra* note 2, at 3.

[13] During one of the FDIC's public hearings on Walmart's application in April 2006, Senator Jake Garn (R-UT) – the sponsor of the 1987 exemption for ILCs – 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." Arthur E. Wilmarth, Jr., *Wal-Mart and the Separation of Banking and Commerce*, 39 CONN L. REV. 1539, 1541-53 (2007) (quoting Sen. Garn's statement on April 10, 2006, during one of the FDIC's three public hearings on Walmart's application) [hereinafter "*Wal-Mart*"].

[14] *See, e.g.*, *COVID 19 and the Federal Student Loan Market*, CAPCO (last visited June 30, 2020), https://capco.com/Intelligence/Capco-Intelligence/COVID-19-and-the-Federal-Student-Loan-Market (one of several industry reports stating federal student loan servicers should expect to see their cash flow negatively impacted during the pandemic).

[15] U.S. DEP'T OF ED. OFFICE OF INSPECTOR GENERAL, FEDERAL STUDENT AID: ADDITIONAL ACTIONS NEEDED TO MITIGATE THE RISK OF SERVICER NONCOMPLIANCE WITH REQUIREMENTS FOR SERVICING FEDERALLY HELD STUDENT LOANS, ED-OIG/A05Q000, 2 (2019) https://www2.ed.gov/about/offices/list/oig/auditreports/fy2019/a05q0008.pdf (arguing

should not be allowed to become an ILC and gain easier access to cash when the industry's business model has so many unaddressed problems, including garnishment of borrower's wages, credit reporting issues, and more. The second, Square, is a retail payments processor founded by Twitter-founder Jack Dorsey. Square already takes advantage of a partnership with Utah-based ILC (Celtic Bank) to override state interest rate caps and other protections (the recent rule finalized by the FDIC and OCC only reinforce this "rent-a-bank" relationship).[16] If Square were directly insured by the FDIC and granted other advantages, it would be in an even better position to charge borrowers otherwise impermissibly high rates at a time when consumers are desperate for credit. This might be good for Square, but bad for its consumers, and worse for the broader public, who would be supporting Square's attempt to stay afloat when its central business model is of questionable durability.[17] Companies like Nelnet and Square should not be allowed to evade state protections put in place to protect consumers from harm to maintain their profitability.

The ILC Loophole Undermines the Longstanding Separation between Banking and Commerce

In general, the sorts of business relationships facilitated by the Proposed Rule threaten the integrity of our economy.[18] We strongly agree with other commenters that ILC rules should adhere to Congress's strongly articulated purpose of separating banking and commerce.[19] Historically, commercially-owned banks have made unsound loans to business partners, denied services to competitors, and generally engaged in imprudent activities to spur commercial user purchases.[20] Commercial firms that also engage in financial services tend to use such enterprises to fund other risky business activities, heightening the moral hazard of bailout.[21] Finally,

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that Federal Student Aid has failed to establishing policies and procedures that provided reasonable assurance that the risk of servicer noncompliance with requirements for servicing federally held student loans has been mitigated).

[16] *See* Press Release, National Consumer Law Center, Advocates Condemn FDIC Rule that Encourages Predatory High-Cost Loans; Call on Congress to Pass Federal 36% Interest Rate Cap Limit, (June 25, 2020) https://www.nclc.org/uncategorized/advocates-condemn-fdic-rule-that-encourages-predatory-high-cost-loans-call-on-congress-to-pass-federal-36-interest-rate-cap-limit.html.

[17] *See* Chris Brummer & Aaron Klein, *Fintech and the coronavirus pandemic, Ep. 44,* FINTECH BEAT, https://podcasts.apple.com/us/podcast/fintech-and-the-coronavirus-pandemic-ep-44/id1466867273?i=1000469312990 (discussing uncertainty regarding cash flows for small business fintech lenders).

[18] See, e.g., FDIC, Moratorium on Certain Industrial Loan Company Applications and Notices, 2006, https://www.fdic.gov/news/news/press/2006/pr06073a.html ("The FDIC has noted a recent increase in deposit insurance applications for, and change in control notices with respect to, ILCs that will be affiliated with commercial concerns or other companies that will not have a Federal consolidated supervisor. Some members of Congress, the Government Accountability Office, the FDIC's Office of Inspector General, and members of the public have expressed concerns regarding the lack of Federal consolidated supervision, the potential risks from mixing banking and commerce and the potential for an unlevel playing field.")

[19] *See* Wilmarth Comment *supra* note 2, at 5.

[20] *Wal-Mart*, *supra* note 13, at 1598-1606.

[21] *Id.* at 1569.

allowing Big Tech companies to take advantage of federal deposit insurance and other attendant protections threatens responsible practices within the tech sector generally.[22]

No one is confused as to why commercial firms would clamor for ILC designation under the Proposed Rule. Benefits include (1) low-cost funding from FDIC-insured deposits, (2) access to the Fed's emergency lending programs for depository institutions, and (3) access to Fed-supervised payments systems for checks, credit cards, debit cards, online and mobile payments, and wire transfers. All without consolidated supervision. Commercial conglomerates large and sophisticated enough to satisfy the capital requirements and other conditions set forth in the Proposed ILC Rule would gain significant advantages over smaller and humble companies.[23] With market dominance, tech companies tend to engage in a wide variety of harmful practices that are not properly regulated by the FTC, DOJ, and other bodies.

For instance, Square's newly-approved ILC intends to offer loans to merchants (up to 40% APR) that process their credit card transactions through Square's proprietary payments system.[24] Antitrust regulators should immediately anticipate *product tying* and *predatory pricing* issues.[25]

In some ways, the bid by online retail giant Rakuten should worry the FDIC even more than the Walmart ILC bid in the early 2000s. Although commenters are quick to compare the Japanese e-commerce giant to Amazon, the company has a different business model. It is driven by loyalty programs that provide cash and other rewards for online purchases.[26] Although Rakuten does not sell its own products on its e-commerce platforms in Japan as Amazon does in the United States, this does not mitigate broader concerns regarding unfair competition.[27] Indeed, the use of reward programs only reinforces our general antitrust concerns: it would be easy for Rakuten to condition rewards for other products based on engagement with its ILC.

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[22] For relevant background, see, e.g., L. Randall Wray, *Global Financial Crisis: Causes, Bail-Out, Future Draft*, 80 UMKC L. REV. 1101, 1107 (2012) (describing how the shift of economic power to shadow banks triggered the operation of "Gresham's Law", whereby safer and stabler financial firms were driven out of business).
[23] *See* Wilmarth Comment, supra note 2, at 16.
[24] *See* Erica Sappala, *Understanding Your Square Capital Loan Offer*, MERCHANT MAVERICK https://www.merchantmaverick.com/understanding-square-capital-loan-offer/.
[25] *See, e.g.*, Letter from Ams. for Fin. Reform Ed. Fund & Demand Progress Ed. Fund to H. Comm. on the Judiciary (Apr. 17, 2020), https://ourfinancialsecurity.org/2020/04/joint-letter-promote-tradition-of-separating-banking-and-commerce-regarding-dominant-platforms/ (arguing for the structural separation of large tech platforms and payments) [Hereinafter "AFR DP Judiciary Letter"].
[26] Brendan Pedersen, *14 years after Walmart, banks face a new ILC bogeyman*, AM. BANKER (Oct. 24, 2019), https://www.americanbanker.com/news/14-years-after-walmart-banks-face-a-new-ilc-bogeyman.
[27] Graham Steele, *Facebook's Libra cryptocurrency is part of a disturbing financial trend,* WASH. POST (Aug. 12, 2019), https://www.washingtonpost.com/outlook/2019/08/12/facebooks-libra-cryptocurrency-is-part-disturbing-financial-trend/.

Unfair competition methods seem especially likely when we consider the prospective use of data collected on both customers and competitors. In general, a nonfinancial affiliate providing an e-commerce platform linking customers and merchants could use data from customer accounts at the ILC to set prices for consumer purchases.[28] One representative from Rakuten has attempted to rebuff criticism on this account by saying that "synergy doesn't apply to financial data" and the company wouldn't sell data to third parties or affiliates unless it's *allowed via customer opt-in* (emphasis added).[29]

There are multiple problems with this statement. First, it is untrue that "Covered Companies" under the Proposed Rule would be subject to the same sort of privacy regulations as purely financial institutions. In fact, there are few privacy protections on the use of financial data, period.[30] Yet banks have commercial reasons *not* to share certain personal data. Banks understand that the core transactional data and increasingly the identity data is unique to banks. Customers do not expect their banks to capture data that would support commercial business lines, outside of contexts regulated by the Fair Credit Reporting Act (FCRA).[31] Here, a reference to Rakuten's own ILC application is illustrative. In direct contradiction to recent statements, last July the company stated its overarching aim would be a "synergistic ecosystem" linking financial technology and its internet services "in the form of an online marketplace that creates strong loyalty and value for both merchants and consumers who sell and shop there, respectively."[32] Finally, while Rakuten might not intend to sell data directly to other companies, their official statement does not preclude the company from selling *access to their users based on the collected data.* This is a fundamental feature of targeted advertisement.

Second, the Rakuten representative's assertion that financial and social data would not be commingled absent consumer consent is virtually meaningless. The very notion of digital consent has been complicated by "dark patterns" and other technology platforms used to exploit limits in user cognition and understanding.[33] Consumers typically have no knowledge of what

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[28] Pedersen, *supra* note 26.
[29] *Id.*
[30] Heather Hogsett, *Consumer Protections and the Digital Evolution in Banking*, MORNING CONSULT (Feb. 13, 2020), https://morningconsult.com/opinions/consumer-protections-and-the-digital-evolution-in-banking/.
[31] *See* Astra Taylor & Jason Sadowski, *How Companies Turn Your Facebook Activity Into a Credit Score*, THE NATION (May 27, 2015), https://www.thenation.com/article/archive/how-companies-turn-your-facebook-activity-credit-score/ (arguing Big Data companies already generate unregulated consumer reports despite protestations otherwise).
[32] Pedersen, *supra* note 26.
[33] *See, e.g.*, Neil Richards & Woodrow Hartzog, *The Pathologies of Digital Consent*, 96 WASH. U. L. REV. 1461, 1461-1478 (2019) (borrowing a definition of dark patterns as "'tricks used in websites and apps that make you buy or sign up for things that you didn't mean to.'"). For instance, consent could be gained by inserting a clause in extensive terms and conditions. *See, e.g.,* Thibault Schrepel, *Libra: A Concentrate of 'Blockchain Antitrust',* 118 MICH. L. REV. ONLINE 160, 166 (2020).

they are consenting to on the internet.[34] Many experts argue the notice-and-consent regime does nothing to curb commercial surveillance.[35]

Third, data collection in the ILC context is its own form or arbitrage.[36] Providing data processing, data storage, and data transmission services is permissible for Bank Holding Companies (BHCs) and their subsidiaries. However, the Bank Holding Company Act (BHCA) limits the activities of BHCs and their subsidiaries to banking, managing and controlling banks and other subsidiaries, and performing services for its subsidiaries.[37] As mentioned, many marketplace lenders are able to offer consumer loans using software tools that utilize non-traditional data for underwriting. If the company decides to process data collected from a customer's social media accounts or their lifestyle choices, it could avoid these rules. Regulation explicitly allows collection of data that is "financial, banking, or economic" in nature but forbids processing or storing nonfinancial data if the total annual revenue derived from those activities exceeds 49% of the revenues derived from data processing.[38]

Some activities that ILC fintech applicants engage in would not be permissible under the BHCA. For example, Square owns several subsidiaries that are engaged in operations such as online scheduling for merchants, food delivery, and predictive data analytics in general. None of these services are listed under the permissible activities list of Board Regulation Y.[39] Without the ILC loophole, Square would most likely have to cease the non-banking activities of some of its subsidiaries or would be required to limit these activities to its internal operations.[40]

We strongly advise against eroding the barrier between Wall Street and Silicon Valley any further.[41] We agree with Prof. Wilmarth that Big Tech firms would not be satisfied with making "toehold" acquisitions of ILCs and will do what they can to take advantage of the loophole, including by making deals with private equity investors to meet requirements codified

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[34] Comment from Freedom from Facebook to FTC (Aug. 20, 2018), https://www.ftc.gov/system/files/documents/public_comments/2018/08/ftc-2018-0051-d-0008-147767.pdf.
[35] *See, e.g.*, Nizan Geslevich Packin & Yafit Lev-Aretz, *Big Data and Social Netbanks: Are You Ready to Replace Your Bank?*, 53 Hous. L. Rev. 1211, 1279–81 (2016); Nathan Newman, *How Big Data Enables Economic Harm to Consumers, Especially to Low-Income and Other Vulnerable Sectors of the Population*, 18 J. Internet L. 11, 19 (2014).
[36] *See generally* Cinar Oney, *Fintech Industrial Banks and Beyond: How Banking Innovations Affect the Federal Safety Net*, 23 Fordham J. Corp. & Fin. L. 541, 552–53 (2018).
[37] *See* 12 U.S.C. § 1843(a)(2).
[38] *See* 12 C.F.R. § 225.28(b)(14) (2017).
[39] *Cf.* 12 C.F.R. § 225.28 (2017).
[40] *Examining the Fintech Landscape: Hearing Before the S. Comm. on the Banking, Hous., & Urban Affairs*, 115th Cong. 66 (2017) (prepared statement of Frank Pasquale, Prof. of Law, Univ. of Maryland Francis King Carey School of Law), *available at* https://www.banking.senate.gov/download/pasquale-testimony-9-12-17pdf.
[41] *See* Wilmarth Comment, *supra* note 2, at 16.

in the Proposed Rule.[42] In general, we support the bright-line separation of dominant technology platforms and the financial services sector.[43]

Overall, the FDIC risks "becoming the agency of choice for questionable fintech firms that seek a pathway to the cheap funding source...and other benefits that a bank charter may provide."[44] But neither the FDIC nor any other federal financial regulatory agency has the experience and resources needed to regulate large data collection firms. In the worst scenario, we fear acquisitions of ILCs by Big Tech firms would create intense pressures for removing all of the BHC Act's restrictions on joint ownership of banks and commercial firms.

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

ILCs have frequently failed due to problems such as reckless lending, inadequate capital, and insufficient liquidity. Thirteen ILCs failed between 1982 and 1984.[45] ILCs declined from 58 to 23 between the beginning of the financial crisis in 2007 and the end of 2019, and the total assets of ILCs dropped from $177 billion to $141 billion.[46] Moreover, several parent companies failed and were rescued by the federal government during the global financial crisis. Other parent companies, including General Motors Acceptance Corp.[47] (GMAC), Merrill Lynch, Goldman Sachs, and Morgan Stanley, would have failed had they not received generous bailouts.[48]

In the case of some ILC bailouts, the danger of contagion arose from the ILC's activities. But in most cases, the dangers flowed from the broader activities of the parent company and the ILC came to serve as a source of strength for the broader conglomeration.[49] In either case, the integration between these two types of company is dangerous: federal regulators have been forced to rescue several entities to reduce the danger of damage spilling between the financial system and the general economy.

The FDIC's limited supervisory powers over parent companies and other affiliates of ILCs are plainly inadequate to prevent the systemic risks, conflicts of interest, and threats to

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[42] AFR SoFi Letter*, supra* note 9.
[43] AFR DP Judiciary Letter, *supra* note 17.
[44] *See* CRC Letter, *supra* note 8, at 1-2.
[45] *See* Wilmarth Comment, *supra* note 2, at 6.
[46] Wilmarth, *supr*a note 12, at 1549-53, 1572-73, 1597, 1615-16.
[47] *See* Wilmarth Comment, *supra* note 2, at 7.
[48] *Id.*
[49] AFR SoFi Letter*, supra* note 10.

competition and consumer welfare created by commercially-owned ILCs.[50] As Prof. Wilmarth has noted, the FDIC has only cited two statutes that would empower it to exercise any meaningful degree of supervision over Covered Companies that would control ILCs under the proposed rule. The FDIC may examine "the affairs of any affiliate."[51] It may also require a Covered Company "to serve as a source of financial strength" for its subsidiary. [52] But even assuming the Corporation has the ability to allow the FDIC to exercise consolidated supervision necessary for corporate-financial conglomerates, the resulting regime would still fall well short of the comprehensive, consolidated supervision that the Fed exercises over BHCs per the BHCA. The FDIC also could not impose consolidated capital requirements or consolidated liquidity requirements on Covered Companies, or require them to conduct stress tests, or to prepare resolution plans.[53]

The eight commitments proposed by the FDIC fail to achieve parity with the regime of consolidated supervision required for BHCs.[54] To clarify, such a regime must include the following elements:

- Consolidated capital and liquidity standards for the covered company, including both the depository ILC and all affiliated entities under common ownership. Such capital and liquidity standards should be comparable to those imposed on BHCs of similar size and systemic significance.

- Mandatory enterprise-wide examinations of the Covered Companies that include all of the examination focuses and areas incorporated in BHC examinations.

- Examination for compliance with Volcker Rule requirements.

- Examination for compliance with restrictions on inter-affiliate transactions laid out in Sections 23A and 23B of the Federal Reserve Act. This is particularly critical as in the absence of controls on inter-affiliate transactions regulation of the ILC subsidiary alone will not be effective in controlling prudential risks.

- Examination for compliance with Gramm-Leach-Bliley Act provisions on data safeguards and privacy of customer financial information that apply to all areas of the Covered Company.

- Mandatory consolidated reporting to banking regulators of similar information as BHCs are required to report to the Federal Reserve.

[50] *See* Wilmarth Comment, *supra* note 2, at 10.
[51] 12 U.S.C. § 1820(b)(4).
[52] 12 U.S.C. § 1831o-1(b).
[53] 12 U.S.C. § 5365. *See also* Wilmarth Comment, *supra* note 2, at 17-18.
[54] *See* Proposed Rule at 17778-82, 17785-86 (discussing and quoting proposed 12 C.F.R. 354.3 and 354.4).

It is striking that none of the above-listed core elements of BHC supervision are included in the proposed eight commitments that a Covered Company must agree to under the Proposed Rule.

In the absence of agreement by a Covered Company to such requirements, the FDIC cannot guarantee that the covered company is a reliable source of strength to its ILC subsidiary, and thus also cannot determine the extent and nature of the risks that could be presented by the chartered subsidiary to the deposit insurance fund. Covered Companies that are not required to abide by these requirements would also compete on an uneven playing field with BHCs that are required to comply with them.

Overall, the FDIC's authority to reject the application of an institution that poses a significant risk to the deposit insurance remains a safeguard against moral hazard.[55] It must not start offering federal deposit insurance to commercial companies with questionable motives and business models. Large commercial owners of ILCs would almost certainly be considered “too big to fail” by regulators and market participants. Their presumed “too big to fail” status, along with their would also make them “too big to discipline adequately.”[56]

Congress Should Close the ILC Loophole

A 2016 joint report evaluated the risks of bank activities and affiliations, as required by Section 620 of the Dodd-Frank Act.[57] The Board recommended that Congress should prohibit ownership of ILCs by commercial firms, based on the same risks and policy concerns cited by the FDIC when it adopted and extended its moratorium.[58] The FDIC did not endorse the Board’s recommendation in the 2016 joint report, but the FDIC did not object to the Board’s recommendation either. Moreover, it did not challenge the Board's analysis of the risks and policy concerns created by commercially-owned ILCs.[59]

We now echo the Board’s previous calls to permanently end the ILC exemption. Arbitrage of our prudential regulatory system is unacceptable. Moreover, the FDIC’s Proposed Rule is silent on the continued monopolization of markets and the dangers of commercial surveillance. In sum, we urge the FDIC to not only discard the Proposed Rule, but to maintain the moratorium on ILC approval until Congress closes the loophole.

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[55] Zachariah J. Lloyd, *Waging War with Wal-Mart: A Cry for Change Threatens the Future of Industrial Loan Corporations*, 14 Fordham J. Corp. & Fin. L. 211 (2008).
[56] *See* Wilmarth Comment, *supra* note 2, at 19.
[57] Bd. of Governors of the Fed. Res. Sys. et al., Report to the Congress and the Financial Stability Oversight Council Pursuant to Section 620 of the Dodd-Frank Act (2016), *available at* https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160908a1.pdf [https://perma.cc/3UDT-MKRV].
[58] *Id.* at 28-29, 32-35.
[59] *Id.* at 52, 74.

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Sincerely,
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