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Industrial Loan Companies (ILCs): Background and Policy Issues

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SUMMARY

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David W. Perkins
Specialist in
Macroeconomic Policy

Industrial Loan Companies (ILCs): Background and Policy Issues

Industrial loan companies (ILCs)—financial institutions chartered by a small number of states—operate in almost every way like a commercial bank, including taking deposits insured by the Federal Deposit Insurance Corporation (FDIC). In many ways, ILCs are subject to the same laws and regulations as all state banks; however, notable differences between the rules applicable to the parent holding companies of ILCs and those applicable to bank holding companies have made ILCs the subject of long-standing debate. Recent efforts by technology-focused financial services companies (financial technology or "fintech" companies) to establish new ILCs have elevated the visibility of ILC policy issues.

The ILC segment of the FDIC-insured depository industry is relatively small; as of March 31, 2020, 23 ILCs were operating in 5 states. Their combined assets made up less than 1% of all FDIC-insured institutions' combined total assets. This small segment draws attention because ILCs are, provided they meet certain criteria, excluded from the definition of a bank under the Bank Holding Company Act (BHCA; P.L.84-511). As a result, parent companies that own ILCs are not prohibited from operating industrial or commercial enterprises (i.e., companies producing or selling nonfinancial goods and services) and are not subject to supervision by the Federal Reserve, as are bank holding companies.

Opponents of the BHCA exemption argue that this exemption allows for a blending of banking and commerce that U.S. policy generally has sought to avoid. In their view, the blending of banking and commerce creates incentives for imprudent underwriting, inappropriately extends government-backed bank safety nets, and increases opportunities for companies to exercise distortionary market power. In addition, opponents argue that lack of Federal Reserve supervision of ILCs results in inadequate regulatory oversight, placing banks and their holding companies at a disadvantage. Proponents argue that ILCs allow for a degree of banking and commerce blending that, on net, is beneficial, allowing organizations to realize economies of scope and information efficiencies, diversify risks, provide customer convenience, and increase the availability of credit and financial services. Proponents also argue that existing FDIC and state-level regulation and supervision are sufficient to mitigate risks.

Policymakers periodically have addressed ILC-related issues since the 1910s. Early on, states enacted ILC-related laws; these laws were not uniform, and some states permitted ILCs to take deposits. After the FDIC was established in 1933, it granted deposit insurance to ILCs on a case-by-case basis, depending on the state laws applicable to and practices of the individual ILCs. Over time, the differences between banks and ILCs narrowed, leading to calls for FDIC insurance to be more widely available to insure deposits at ILCs. The Garn-St. Germain Depository Institutions Act (P.L. 97-320) explicitly made ILCs eligible for FDIC insurance in 1982, and states began requiring ILCs to be FDIC-insured. The current regulatory framework for ILCs was in large part shaped by the Competitive Equality Banking Act (CEBA; P.L. 100-86) in 1987, as the law exempted an ILC's parent from the BHCA, thus creating the avenue for commercial enterprises to own an institution that could offer FDIC-insured deposits.

Efforts by Walmart and The Home Depot to own ILCs in the mid-2000s resulted in widespread objections related to fears that large retailers would exercise anticompetitive market power. These objections led to two official moratoriums on FDIC insurance approvals for ILCs spanning from 2006 to 2008 (as implemented by the FDIC) and from 2010 to 2013 (as mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act [P.L. 111-203]). The debate has been reignited by recent applications, including one by a large Japanese retailer. In March 2020, the FDIC approved two new ILC applications and issued a proposed rule on ILC applications.

As these developments unfold, Congress may consider ILC-related issues. If Congress were to decide to restrict ILCs, then making new ILCs ineligible for FDIC insurance, repealing the BHCA exemption, or partially amending aspects of their current regulation could be options with varying degrees of restriction. For example, S. 2839 would subject ILC holding companies to Federal Reserve supervision and prohibit commercial firms from becoming ILC holding companies. Were Congress to decide it does not want to restrict ILCs or hinder their establishment, it could expand ILC access to FDIC insurance, perhaps by placing requirements on the FDIC to grant insurance if certain conditions are met. If Congress wanted to prevent the establishment of new ILCs while it considers the issues at hand, it could implement another moratorium.

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Introduction

In recent years, several technology-focused financial service companies (sometimes characterized as financial technology or "fintech" companies) have applied to state bank regulators and the Federal Deposit Insurance Corporation (FDIC) to establish an *industrial loan company* (ILC; also called industrial banks or industrial loan corporations). ILCs are state-chartered institutions that can be, depending on the state, allowed to make loans, process payments, and take deposits insured by the FDIC.[1] In short, ILCs provide bank services. Certain ILC applications—and the FDIC's approval of two ILC applications in March 2020—have reignited a policy debate over whether aspects of ILC regulation contravene long-standing U.S. banking policy.

ILCs are controversial because under the Banking Holding Company Act (BHCA; P.L. 84-511), they are exempt from the definition of a bank,[2] allowing a degree of blending of a banking enterprise and a commerce enterprise. The BHCA generally subjects companies that own banks to regulation and supervision by the Federal Reserve and prohibits them from owning nonfinancial enterprises.[3] Because ILCs are exempt from the definition of a bank under the BHCA, ILC parent companies are not subject to the prohibition against commercial ownership or to Federal Reserve supervision.

Since at least as far back as the Glass-Steagall Act (Sections 20, 21, 26, and 32 of The Banking Act of 1933; P.L. 73-66), Congress generally has sought to separate banking enterprises that take deposits and make loans from commercial enterprises producing and selling goods and services. The rationale for this policy is to prevent various potential negative outcomes, including an increased occurrence of imprudent lending backed by government safety nets and an increased likelihood of organizations exercising distortionary market power.[4] On the other hand, those who favor ILCs discount arguments for strict separation of banking and commerce and maintain that these mixed enterprises provide potential benefits—including economies of scope, risk diversification, information efficiencies, and customer convenience—that could exceed the potential costs resulting from the extension of government safety nets and reduced competition.[5]

This report examines ILCs and related policy issues. It begins with an overview of ILCs and the current state of the industry. Next, the report examines the policy issues raised by ILCs. It then summarizes the current regulatory framework's development and examines industry and policy developments since 2005. These developments include the FDIC's and Congress's implementation of moratoriums on new ILC approvals and recent developments involving fintech companies. The report concludes with brief descriptions of selected, possible legislative alternatives.

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[1] James R. Barth and Yanfei Sun, *A New Look at the Performance of Industrial Loan Corporations*, University of Utah, Utah Center for Financial Services, January 2018, p. 6, at http://industrialbankers.org/wp-content/uploads/2018/10/ILC_REPORT_BARTH_2018.pdf (hereinafter Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*).

[2] 12 U.S.C. §1841(c)(2)(H).

[3] 12 U.S.C. §§1843-1844.

[4] Independent Community Bankers of America (ICBA), *Industrial Loan Companies: Closing the Loophole to Prevent Consumer and Systemic Harm*, March 2019, pp. 1-4, at https://www.icba.org/docs/default-source/icba/advocacy-documents/reports/ilc-white-paper.pdf (hereinafter ICBA, *Industrial Loan Companies: Closing the Loophole to Prevent Consumer and Systemic Harm*).

[5] Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*, pp. 38-40.

Overview of Industrial Loan Companies

ILCs are financial institutions chartered in a small number of states—currently, California, Hawaii, Minnesota, Nevada, and Utah[6]—that are permitted to make a wide array of loan types, offer most types of deposit accounts, and open branches across state lines. Except for a federal law that technically restricts their ability to offer checking accounts (discussed later in this section), they, in effect, act as full service banks. As is the case with traditional banks, an ILC may be owned by a parent *holding company*.[7]

In general, the regulation of banks and ILCs, where it relates directly to the insured depository, are similar.[8] The Federal Deposit Insurance Act (FDI Act; P.L. 81-797) defines "state bank" to include ILCs.[9] As with any state bank that is not a member of the Federal Reserve System, the FDIC is the primary federal regulator of ILCs and supervises them along with the chartering state's bank agency. (Currently, there are no ILC members of the Federal Reserve System.) As a result, state bank regulators and the FDIC subject state-chartered banks and ILCs to supervision and regulation, including safety and soundness requirements (e.g., capital standards and restrictions on transactions with insiders), as well as compliance with federal consumer protection, community reinvestment, and anti-money laundering laws.[10]

Certain federal laws and regulations that apply to bank holding companies (BHCs) also apply to ILC holding companies: notably, Sections 23A and 23B of the Federal Reserve Act (P.L. 663-43) prohibiting or restricting certain transactions between banks and their affiliates.[11] In addition, under Section 38A of the FDI Act, as amended by Section 616 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank; P.L. 111-203), the FDIC must require the parent company of an ILC to "serve as a source of financial strength" for the depository ILC.[12]

These similarities aside, the regulation of the parent holding companies of banks and ILCs differ in a significant way. Under the Bank Holding Company Act (BHCA; P.L.84-511), a parent company that owns a *bank*, as defined in that act, is designated as a BHC.[13] BHCs are generally prohibited from owning nonfinancial enterprises[14] and are subject to supervision by the Federal Reserve.[15] ILCs that meet certain criteria are exempt from the BHCA definition of a bank.[16] Thus,

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[6] These states were permitted to grandfather existing industrial banks and continue to charter new industrial banks under the Competitive Equality Banking Act (CEBA; P.L. 100-86). Colorado was also grandfathered, but the state has no active industrial banks and has since repealed its industrial bank statute. See Federal Deposit Insurance Corporation (FDIC), "Parent Companies of Industrial Banks and Industrial Loan Companies," 85 *Federal Register* 17773, March 31, 2020.

[7] FDIC, "Parent Companies of Industrial Banks and Industrial Loan Companies," 85 *Federal Register* 17771-17773, March 31, 2020.

[8] For more information on bank regulation, see CRS Report R44918, *Who Regulates Whom? An Overview of the U.S. Financial Regulatory Framework*, by Marc Labonte.

[9] 12 U.S.C. §1813(a)(2).

[10] FDIC, "Parent Companies of Industrial Banks and Industrial Loan Companies," 85 *Federal Register* 17771-17773, March 31, 2020.

[11] 12 U.S.C. §371c, 12 U.S.C §371c-1, 12 U.S.C. §1828(j), and 12 U.S.C. §1468.

[12] 12 U.S.C. §1831o-1(b).

[13] 12 U.S.C. §1841.

[14] 12 U.S.C. §1843.

[15] 12 U.S.C. §1844.

[16] 12 U.S.C. §1841(c)(2)(H). The set of criteria most pertinent to this report is that the ILC is chartered in a state that required ILCs to have FDIC insurance as of March 5, 1987, and that institution (1) does not except demand deposits,

parent companies that own an ILC are not designated as BHCs and are not subject to prohibitions against commercial activity or to the Federal Reserve's direct supervision.[17]

To qualify for the BHCA exemption, ILCs cannot offer *demand deposits* (i.e., checking accounts or other deposits that the depository institution generally must make available to the depositor for withdrawal within less than seven days' notice).[18] Instead, ILCs generally offer *negotiable order of withdraw* (NOW) accounts. NOW accounts are not considered demand deposits because the depository reserves the right to require seven days' notice or more to transfer the funds.[19] In practice, ILCs may choose to make funds available upon request and not avail themselves of the allowable seven days. Thus, a NOW account functions as a checking account from the perspective of an ILC customer, although it is not technically a demand deposit account.[20]

As of the end of the first quarter of 2020, there were 23 FDIC-insured ILCs chartered in 5 states, 14 of which were chartered in Utah.[21] As shown in **Table 1**, these ILCs collectively held almost $165 billion in assets and $135 billion in deposits; both amounts are less than 1% of the total amount held by all insured depositories.[22] Some of these ILCs are owned by parent companies that are primarily involved in finance, including large organizations like UBS (a non-U.S. bank) and Sallie Mae (a student loan company). Nonfinancial commercial companies, including Toyota and BMW, own others. Some ILCs are small, niche lenders. For example, Medallion Bank specializes in loans for taxi cab "medallions"—licenses to operate taxis issued by large cities—and EnerBank is owned by a home construction company and makes construction loans.

Currently, the ILC industry is relatively smaller than it has been at other times in recent history, although it has always been smaller compared with the overall depository industry. For example, there were 54 FDIC-insured ILCs with nearly $264 billion in assets in 2007.[23] The industry shrunk following the 2007-2009 financial crisis for numerous reasons. Companies such as Goldman Sachs, Morgan Stanley, and General Motors converted their ILCs to commercial banks during the crisis and became BHCs. Other ILCs voluntarily closed, including those owned by GE and Target, and two small ILCs failed.[24] However, there are recent indications that there may be a resurgence of interest in establishing ILCs, including among technology-focused companies (as discussed in the "Latest Developments" section, below).

(2) has less than $100 million in assets, or (3) is not acquired by another company after August 10, 1987. This is discussed in more detail in the "Current Regulatory Framework: 1987-Present" section, below.

[17] An exception in which the Federal Reserve would have authority over an ILC parent holding company is if an ILC or the parent is designated a *systemically important financial institution*, or SIFI. Previously, one ILC was designated as a SIFI; currently, there are no ILCs designated as SIFIs. See more detail, see CRS Report R42150, *Systemically Important or "Too Big to Fail" Financial Institutions*, by Marc Labonte.

[18] 12 C.F.R. §204.2(b)(1).

[19] 12 C.F.R. §204.2(b)(3).

[20] ICBA, *Industrial Loan Companies: Closing the Loophole to Prevent Consumer and Systemic Harm*, pp. 5-6.

[21] Email correspondence between the author and the FDIC Office of Congressional Liaison, January 8, 2020; and Federal Financial Institutions Examinations Council, "Bulk Data Download," at https://cdr.ffiec.gov/public/PWS/DownloadBulkData.aspx.

[22] FDIC, *Quarterly Banking Profile*: *First Quarter 2020*, at https://www.fdic.gov/bank/analytical/qbp/2020mar/qbp.pdf#page=1; and Congressional Research Service (CRS) calculations.

[23] Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*, p. 9.

[24] Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*, pp. 9-10.

Table 1. Industrial Loan Company (ILC) Number, Assets, and Deposits, by State
(as of March 31, 2020; $ in billions)

State	Number	Total Assets	Total Deposits
Utah	14	$153.70	$100.99
Nevada	4	$9.66	$5.13
California	3	$0.69	$0.58
Hawaii	1	$0.60	$0.41
Minnesota	1	$0.03	$0.02
Total ILCs	23	$164.7	$107.1
Total FDIC-insured	5,165	$20,266	$14,340
ILCs as % of total	0.4%	0.8%	0.7%

Sources: Email correspondence between the author and FDIC Office of Congressional Liaison, January 8, 2020; Federal Financial Institutions Examinations Council, "Bulk Data Download" at https://cdr.ffiec.gov/public/PWS/DownloadBulkData.aspx; and Congressional Research Service calculations.

Policy Issues Raised by ILCs

ILC debates primarily involve two policy issues. One is related to the general separation of banking and commerce. ILC opponents often argue that the ownership of deposit-taking ILCs by commercial enterprises allows too much blending of activities and too many associated risks. Proponents often argue that there are important benefits of ILCs as operated under current laws and regulations, and that ILCs as financial services providers are appropriately regulated. The other issue is the related question of whether parent companies that own ILCs should be subject to Federal Reserve supervision, as BHCs are. This section examines these policy issues.

Separation of Banking and Commerce Policy Debate

Historically, the United States has adopted policies that separate banking enterprises from commercial enterprises. These policies serve to prevent various interrelated outcomes, described below.

Arguments for Strict Separation

One potential issue with mixing banking and commerce within a single organization is that the bank subsidiary could have incentives to make decisions based on the interests of the larger organization, instead of on safe and sound banking principles.[25] For example, a consumer who wishes to remodel his kitchen may need to take out a loan to buy appliances and fixtures from a retail company. If the consumer were to apply for the loan at a stand-alone bank, whether or not the bank would make the loan and under what terms depends largely on the applicant's ability to repay. If the consumer were to apply for a loan at a bank owned by the retailer, the retailer would make an immediate profit on the sale of the goods, and the retailer-owned bank would later make profit on the loan repayment. Thus, the retailer-owned bank would have incentive to make loans

[25] Kenneth Spong and Eric Robbins, "Industrial Loan Companies: Growing Industry Sparks a Public Policy Debate," Federal Reserve Bank of Kansas City, *Economic Review*, Fourth Quarter 2007, pp. 59-61, at https://www.kansascityfed.org/Publicat/ECONREV/PDF/4q07Spong.pdf (hereinafter Spong and Robbins, "Industrial Loan Companies: Growing Industry Sparks a Public Policy Debate").

to riskier borrowers and at lower interest rates compared with the stand-alone bank. This logic would apply to any scenario in which a bank owned by a commercial parent receives loan applications from the parent's customers and suppliers.

A retailer or other commercial enterprise making a loan may not be considered problematic per se. Whether a company can make profit by lending to its customers or suppliers is a matter of market forces and does not necessarily raise policy concerns—even if the loans are riskier and default at a higher rate. Concerns arise when the enterprise is allowed to raise funding by accepting government-backed deposits. Protecting depositories from possible negative effects of risk-taking—and thus introducing what is known as *moral hazard*—removes certain market incentives that constrain risk-taking (see the "Deposit Insurance Based on FDIC Interpretation: 1933-1982" section, below). One main rationale for extending government guarantees to banks is that bank failures are especially harmful economically and socially, as they expose individuals seeking to keep their money safe—as opposed to investing for returns—to losses. In contrast, commercial enterprises generally are not given government support because their failures are seen as less disruptive and impose losses on return-seeking, risk-accepting investors.[26] For these reasons, proponents of separating banking and commerce argue that separation prevents an inappropriate extension of bank safety nets to commercial enterprises.[27]

Another potential issue with combined banking and commerce enterprises is that their in-house bank operations could increase opportunities for the enterprises to achieve the size and financial resources necessary to exercise anticompetitive market power.[28] Returning to the comparison between the stand-alone bank and a retailer-owned bank, if the retailer-owned bank were able to make loans at a lower interest rate, then it could be difficult for the stand-alone bank to compete. Similarly, a retailer that does not own a bank and fund loans to customers with government-backed deposits may have difficulty competing with a retailer that does. Where blending is allowed, these economies of scale and scope may naturally lead to large conglomerates with the ability to exercise market power, potentially stifling competition and charging consumers prices higher than free market prices.

Arguments Against Strict Separation

Some observers argue that potential benefits of allowing the blending of banking and commerce, at least to a certain degree, could outweigh the potential costs, which separation aims to avoid. Economies of scale and scope—provided they do not lead to the exercise of distortionary market power—are considered beneficial in most contexts. They allow enterprises to be more efficient and to reduce costs.[29] Companies may, depending on market characteristics, pass on cost savings to consumers. For example, a commercial company that pays fees to use the payment processing services of a bank may be able to reduce costs by bringing that process in-house. In addition, a combined enterprise might be more resilient to economic or financial downturns because their risks are diversified; they make income from both banking and commerce, not exclusively one or the other.[30]

[26] Under extraordinary circumstances, the government may act to support certain nonbank companies or industries, such as during the current experience with the coronavirus pandemic and the financial crisis of 2007-2009.

[27] Spong and Robbins, "Industrial Loan Companies: Growing Industry Sparks a Public Policy Debate," pp. 62-64.

[28] Spong and Robbins, "Industrial Loan Companies: Growing Industry Sparks a Public Policy Debate," pp. 61-62.

[29] Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*, pp. 38-40.

[30] Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*, pp. 38-40.

Commercial businesses' relationships with consumers and familiarity with specific market conditions could produce additional benefits. One could be information efficiency (e.g., knowledge about their customers' creditworthiness or needs).[31] For example, if the above hypothetical kitchen remodeler were instead a contractor who regularly made purchases from the retailer, the retailer-owned bank might consider the contractor to be competent and know that home improvement loans have been performing well. A stand-alone bank with no specialization in home remodeling may not have that information and thus might incorrectly judge the merits of the loan application. Customer convenience could also improve if customers were able to shop for goods and services and receive financing at one location at the same time.[32] In the case where commercial-owned banks could more conveniently provide a customer with lower-cost financing based on better information, these would be benefits that could not be realized in the case of a strict separation of banking and commerce.

In the context of the ILC debate, opponents to establishing more FDIC-insured ILCs assert that the risks and costs posed by the blending of banking and commerce warrant stricter separation.[33] Meanwhile, ILC proponents assert that ILCs can use the BHCA exception to provide a safe and efficient source of financing to borrowers who might not otherwise have access to the financial services ILCs provide.[34]

Different Regulatory Treatment Policy Debate

U.S. depository institutions operate under charters offered at the federal and state levels and in various forms, each of which is subject to different regulatory approaches. While these differences have generally narrowed over time, certain differences remain. One of the rationales for a multiple charter system is that it provides the opportunity for institutions with different business models and ownership arrangements to choose a regulatory regime appropriately suited to their business needs and risks. Under this system, multiple institution types are available to meet market needs.[35]

This fragmented regulatory framework also can create challenges. One challenge is that, in some circumstances, institutions engaged in similar businesses may be subject to different regulations.[36] Relatedly, this system may create avenues for institutions to actively seek out charters and ways to structure themselves, largely to side-step certain regulations.[37]

The balance policymakers often aim to strike is to have enough differentiation between charters and regulatory regimes to provide for appropriate tailoring, while not inadvertently creating regulatory gaps that could allow excessive risk to enter the banking system and economy.

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[31] Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*, pp. 38-40.

[32] Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*, pp. 38-40.

[33] ICBA, *Industrial Loan Companies: Closing the Loophole to Prevent Consumer and Systemic Harm*, pp. 1-4.

[34] Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*, pp. 38-40.

[35] Administrator of National Banks, *National Banks and the Dual Banking System*, Office of the Comptroller of the Currency, September 2003, pp. 10-12, at https://www.occ.treas.gov/publications-and-resources/publications/banker-education/files/pub-national-banks-and-the-dual-banking-system.pdf.

[36] U.S. Government Accountability Office, *Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness*, GAO-16-175, February 25, 2016, pp. 13-19, at https://www.gao.gov/products/GAO-16-175.

[37] For example, see Department of the Treasury, *Financial Regulatory Reform: A New Foundation*, October 2009, pp. 12, 32-33, at https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

Opponents of ILCs argue that the exemption from Federal Reserve regulation and supervision is an example of a problematic loophole that creates a regulatory "blind spot."[38] For example, BHCs are subject to capital ratio requirements and examination by the Federal Reserve; ILC parents are not. ILC proponents argue that current FDIC and state regulation and supervision of ILCs are sufficient.[39] For example, Section 616 of Dodd-Frank added Section 38A to the FDI Act, requiring federal parent regulators to ensure that all federally-regulated depository parents are sources of financial strength for subsidiary depositories. The FDIC has used this authority and others to require ILC parents to enter into agreements consenting to examination by the FDIC.[40]

Development of ILC Regulation

Financial industries and the laws and regulations that apply to them do not spring up together at a moment in time. Instead, practices, institutions, and rules coevolve over time. During this process, practices change, and policymakers try to identify and correct issues as they arise. Sometimes, this can lead to regulations and frameworks that years or decades after implementation seem incongruous or inconsistent. In these cases—which arguably includes the ILC situation in which a type of institution acts in all ways similar to a bank but is specifically excluded from the definition of a bank in a particular law—it can be informative to examine the history of regulation development. This section provides such an examination for the ILC industry.

Before Federal Deposit Insurance: 1910-1933

The first ILCs (as they are now called) started forming in 1910 with the aim of serving a niche lending market. At that time, banks generally required individuals to pledge collateral for a loan. "Industrial" workers (e.g., laborers in factories and mines) generally did not own anything of sufficient value to qualify, but they did have relatively stable incomes. ILCs identified this underserved market and made small, unsecured loans to individuals who could produce references vouching for their creditworthiness. These early ILCs did not accept deposits. Instead, they raised funding by issuing a type of debt security called a *certificate of investment* or *certificate of indebtedness* that was repaid in installments over time (similar to a bond) but in certain cases could be redeemed for cash at the ILC (similar to a deposit).[41]

The industry evolved as it grew. States enacted laws related to ILCs, but they were not uniform. A 1940 study found that by 1938, 31 (of the then 48) states had some provision in state law for the operation of an ILC, and—depending on how one defined an ILC—there were between 317 and 410 ILCs in the United States. The laws and regulations applicable to ILCs varied across states in numerous ways, including in requirements related to permissible loan size, interest, and fees; minimum capital levels; and company organization and governance.[42]

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[38] ICBA, *Industrial Loan Companies: Closing the Loophole to Prevent Consumer and Systemic Harm*, pp.10-12.

[39] Barth and Sun, *A New Look at the Performance of Industrial Loan Corporations*, pp. 38-40.

[40] A recent FDIC proposed rulemaking would codify this practice in regulation, as discussed in the "FDIC Proposed Rulemaking" section, below. For more information, see FDIC, "Parent Companies of Industrial Banks and Industrial Loan Companies," 85 *Federal Register* 17772, 17776-17780, March 31, 2020.

[41] Raymond J. Saulnier, "Nature and Scope of Industrial Lending," in *Industrial Banking Companies and Their Credit Practices*, ed. Raymond J. Saulnier (Cambridge, MA: National Bureau of Economic Research, 1940), pp. 12-15.

[42] Raymond J. Saulnier, "Legal Status," in *Industrial Banking Companies and Their Credit Practices*, ed. Raymond J. Saulnier (Cambridge, MA: National Bureau of Economic Research, 1940), pp. 30-56 (hereinafter Saulnier, "Legal

The most pertinent difference between the states for the issues covered in this report was that some states (about 16 in 1938) permitted ILCs to take deposits, although not all permissioned ILCs necessarily did so.[43]

Deposit Insurance Based on FDIC Interpretation: 1933-1982

Lenders funded exclusively by debt and equity and not by government-guaranteed deposits face certain market constraints and incentives to manage risks that deposit-accepting institutions do not. Investors in debt and equity demand compensation for exposure to risk of losses in the form of higher promised returns and monitor the risk-taking of companies in which they have invested or may invest. When depositors have a guarantee that they will not lose money, they often do not demand as high a return (if any) or monitor risk-taking as closely (if at all). Thus, institutions funded with guaranteed deposits have access to a less costly funding source, face less market constraints in their risk-taking, and have less cyclical volatility in the availability of funding. For this reason, and because of the devastating economic and societal effects depository failures can have, the government closely regulates deposit-taking institutions for safety and soundness. These incentives, regulations, and the extension of government guarantees on deposits are at the heart of the debates surrounding ILCs.

When the FDIC was established by the Banking Act of 1933 (P.L. 73-66) with the mandate to protect depositors from losses, ILC eligibility for FDIC insurance depended on the state laws applicable to and the chosen practices of each individual ILC. As a result, for about the first 50 years of its existence, the FDIC made case-by-case determinations on whether an ILC would be insured.[44] Information from several sources indicates that the FDIC granted insurance to ILCs sparingly. For example, one study found the FDIC insured 71 ILCs in 15 states and the District of Columbia in 1938.[45] As of the end of that year, the FDIC had insured 13,661 institutions in total.[46] An article examining the history of FDIC supervision of ILCs notes that between 1958 and 1979, "at least six" ILCs that had been ineligible for insurance received it after changes to FDIC policy.[47] As of the end of 1979, the FDIC had insured a total of 14,688 institutions.[48]

ILC Eligibility Depending on State: 1982-1987

Congress made a significant change to the FDIC's mandate as it applied to ILCs in the Garn-St. Germain Depository Institutions Act of 1982 (Garn-St. Germain Act; P.L. 97-320). In the years preceding the law's enactment, the differences between the practices of and regulations applicable to ILCs and banks had narrowed. For example, banks and ILCs had each expanded the types of loans they made so that there had become significant overlap. In addition, the elimination of interest rate limits on certain bank accounts by the Depository Institutions Deregulation and

Status," in *Industrial Banking Companies and Their Credit Practices*).

[43] Saulnier, "Legal Status," in *Industrial Banking Companies and Their Credit Practices*, pp. 41-43.

[44] Mindy West, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," *FDIC Supervisory Insights*, Summer 2004, pp. 5-13 (hereinafter West, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective").

[45] Saulnier, "Legal Status," in *Industrial Banking Companies and Their Credit Practices*, p. 42.

[46] FDIC, *Annual Report for the Year Ending December 31, 1938*, June 20, 1939, p. 41, at https://www.fdic.gov/about/financial-reports/report/archives/fdic-ar-1938.pdf.

[47] West, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," p. 8.

[48] FDIC, *Annual Report for the Year Ending December 31, 1979*, August 1, 1980, pp. 139-140, at https://www.fdic.gov/about/financial-reports/report/archives/fdic-ar-1979.pdf.

Monetary Control Act (P.L. 96-221) had made those bank products more similar to ILC certificates, which tended to pay higher rates.[49] This caused certain industry observers to assert that ILCs were in effect operating as banks, and it was in the public interest to guarantee their deposit-like funding.[50] Utah and California established state funds to insure their ILCs' certificates, but a small number of ILC failures quickly depleted those funds.[51]

Subsequent to these developments, Congress passed the Garn-St. Germain Act in 1982, and Section 703 made ILCs and their certificates of investment eligible for FDIC insurance, provided the ILC "is chartered and operating under laws … comparable to laws applicable to banks operating in the same state."[52]

The law did not require ILCs to apply and be approved for FDIC insurance. Relatively few ILCs voluntarily availed themselves of this option because, according to certain observers at the time, they did not want to be subject to FDIC regulation.[53] In response, a few states passed state laws requiring their ILCs to become FDIC-insured.[54]

Current Regulatory Framework: 1987-Present

The Competitive Equality Banking Act (CEBA; P.L. 100-86), enacted in 1987, largely shaped the current regulatory framework and resulting policy debates related to ILCs. One of the CEBA's main aims was to address the issue of "nonbank banks." Nonbank banks were limited-service banks that either made loans or offered deposits, but not both. Under the BHCA at that time, by offering one service but not both, these nonbanks did not meet the definition of a bank. Those that took deposits, however, were FDIC-insured, which provided a mechanism for commercial enterprises and large financial conglomerates to offer FDIC-insured deposits while allowing the parent of the nonbank bank to avoid designation as a BHC subject to Federal Reserve supervision. This scenario came to be viewed as a regulatory loophole, and Congress amended the BHCA definition of a bank in the CEBA.[55]

The CEBA also enacted the exemption for ILCs—institutions that both took deposits and made loans and thus were not the nonbank banks the legislation primarily sought to address—that is at the root of much of today's policy debate. Under the CEBA amended definition, an ILC is not considered a bank if it is chartered in a state that required FDIC insurance on March 5, 1987, and meets one of three conditions: (1) it does not accept demand deposits, (2) it has less than $100 million in assets, or (3) it has not been acquired by another company since August 10, 1987.[56] These conditions restricted the formation of new ILCs. For example, the grandfathering clause restricts the exemption to ILCs to the six states that already had FDIC insurance requirements in

[49] West, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," p. 8.

[50] U.S. Congress, House Committee on Banking, Finance, and Urban Affairs, Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Nonbank Banks*, hearing on H.R. 20, 99th Cong., 1st sess., April 18, 1985, pp. 245 (hereinafter Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Nonbank Banks*, hearing on H.R. 20, 99th Cong.).

[51] West, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," p. 8.

[52] Section 703(c), Garn-St. Germain Depository Institutions Act of 1982 (P.L. 97-320).

[53] Subcommittee on Financial Institutions Supervision, Regulation and Insurance, *Nonbank Banks*, hearing on H.R. 20, 99th Cong., pp. 245-246.

[54] West, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," p. 8.

[55] Lee Davison, "Banking Legislation and Regulation," in *History of the Eighties: Lessons for the Future. Vol. 1, An Examination of the Banking Crises of the 1980s and Early 1990s* (Washington, DC: FDIC, 1997), p. 98.

[56] 12 U.S.C. §1841(c)(2)(H)(i)(I).

place.[57] However, it still created an avenue for new ILCs to form. The secondary condition ILCs most frequently use today to get the exemption is to not accept demand deposits, instead accepting only NOW accounts and time deposits (as discussed in the "Overview of Industrial Loan Companies" section, above).[58] Thus, the CEBA exemption gave an opening for commercial enterprises to offer FDIC-insured deposits and operate what are in effect banks, but the opening is only available in a small number of states.

Recent Controversies and Developments

The current ILC regulatory framework sparked debate several times over the years. At times, this debate attracted widespread concerns over the possibility that certain large retailers were attempting to establish or acquire ILCs. In response, policymakers imposed official moratoriums on ILC approvals for FDIC insurance. Though these moratoriums have ended, the debate continues, as technology companies have applied for and in two cases been granted FDIC insurance. This section examines these developments.

Controversial Applications and Official Moratoriums: 2005-2013

In the 1980s and 1990s, numerous commercial companies with household names—including large manufacturers and retailers, such as General Electric, General Motors, Sears, Target, and Harley-Davidson—established ILCs and attracted little public scrutiny.[59] However, when the large retail companies Walmart and The Home Depot initiated efforts to establish or acquire ILCs, the previously esoteric banking policy debate became a matter of relatively widespread interest, with many members of the general public generally opposed to regulators allowing these retailers to proceed with their plans.[60]

Walmart and The Home Depot began ultimately unsuccessful efforts to secure ILC charters in 2005 and 2006, respectively.[61] Walmart applied to establish a new ILC in July 2005, asserting it sought cost savings in payment processing and would not open retail branches.[62] The Home Depot applied to acquire EnerBank, a Utah-chartered ILC that specialized in home improvement loans. The Home Depot asserted that, by offering home improvement loans in its many retail locations, it would improve access to credit to this market segment.[63]

Public opposition to allowing these companies to acquire ILC charters generally resulted from concerns related to the potential for these large retailers to increase their market power in the retail industry and extend it into banking. Small banks were especially concerned. At that time,

[57] As described in footnote 6, these states are California, Hawaii, Minnesota, Nevada, Utah, and Colorado, though Colorado has no active ILCs and has repealed its ILC statute.

[58] 12 C.F.R. §204.2(c)(1)(i).

[59] James R. Barth et al., *Industrial Loan Companies: Supporting America's Financial System*, Milken Institute, April 2011, p. 4, at http://webhome.auburn.edu/~barthjr/publications/2011/Industrial%20Loan%20Companies.pdf.

[60] Bernard Wysocki Jr., "How Broad Coalition Stymied Wal-Mart's Bid to Own a Bank," *The Wall Street Journal*, October 23, 2006, at https://www.wsj.com/articles/SB116118495912296504.

[61] Michelle Clark Neely, "Industrial Loan Companies Come Out of the Shadows," Federal Reserve Bank of St. Louis, *The Regional Economist Magazine*, July 2007, at https://www.stlouisfed.org/~/media/files/pdfs/publications/pub_assets/pdf/re/2007/c/industrial-loan.pdf (hereinafter Clark Neely, "Industrial Loan Companies Come Out of the Shadows").

[62] Walmart, "Wal-Mart Withdraws ILC Charter Application," press release, March 16, 2007, at https://corporate.walmart.com/newsroom/2007/03/15/wal-mart-withdraws-ilc-charter-application.

[63] Clark Neely, "Industrial Loan Companies Come Out of the Shadows."

Walmart in particular was perceived to be pushing small "Mom and Pop" stores out of the retail industry. If large retailers with numerous locations nationwide were able to provide bank services, community banks were concerned they would be similarly pushed out of business.[64]

Amid that debate and after receiving over 13,000 comment letters about Walmart's application, the FDIC announced an official moratorium in July 2006 on the acceptance, approval, or denial of ILC applications for deposit insurance. In a notice published in the *Federal Register*, the FDIC asserted that, in light of the evolving nature of ILC applicants and the ongoing concerns, the agency needed time to reexamine its policies related to these companies.[65] Shortly afterwards, the FDIC issued a request for comments on issues related to ILCs.[66] In February 2007, the FDIC extended the moratorium[67] and issued proposed rules that would require ILC parents to serve as sources of strength for their ILCs and provide the FDIC with more information on the parent through reporting and examination.[68] The moratorium eventually ended in January 2008[69] but by that time—perhaps due in part to the public controversy and the then-unfolding problems in the financial industry that would culminate in a major crisis—Walmart and The Home Depot had ended their attempts to secure charters.[70] The FDIC did not finalize the February 2007 proposal for numerous reasons, including the onset of the 2007-2009 financial crisis.[71]

Continuing concerns over ILCs led Congress in July 2010 to mandate in Section 603 of the Dodd-Frank Act another moratorium on granting deposit insurance to new ILCs.[72] After this mandatory moratorium ended in July 2013, the FDIC did not approve any new ILC applications for over six years until March 17, 2020, as discussed in the "Latest Developments" section, below.[73]

Post-Moratorium Limbo: 2013-2019

From the end of official moratoriums through the end of 2019, at least six companies—Nelnet, Square, Rakuten, AmeriNat Bank, Interactive Bank, and SoFi, all of which owned and operated nonbank enterprises—submitted applications for ILC charters and FDIC insurance.[74] All of these companies have existing nonbank financial enterprises, and several have substantial commercial operations:

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[64] Shaheen Pasha, "Coming Soon: A Walmart Bank?," *CNN Money*, October 27, 2005.

[65] FDIC, "Moratorium on Certain Industrial Loan Company Applications and Notices," 71 *Federal Register* 43482, August 1, 2006.

[66] FDIC, "Industrial Loan Companies and Industrial Banks," 71 *Federal Register* 49456, August 23, 2006.

[67] FDIC, "Industrial Loan Companies and Industrial Banks," 72 *Federal Register* 5290-5292, February 5, 2007.

[68] FDIC, "Industrial Loan Companies and Industrial Banks," 72 *Federal Register* 5217-5226, February 5, 2007.

[69] John Poirier, "No Extension of ILC Bank Moratorium-US FDIC Chief," *Reuters*, November 28, 2007, at https://www.reuters.com/article/sppage012-n28632744-oisbn/no-extension-of-ilc-bank-moratorium-us-fdic-chief-idUSN2863274420071128.

[70] See Walmart, "Wal-Mart Withdraws ILC Charter Application," press release, March 16, 2007, at https://corporate.walmart.com/newsroom/2007/03/15/wal-mart-withdraws-ilc-charter-application; and Joe Adler, "ILC Debate's New Twist: Home Depot Drops Its Bid," *American Banker*, January 25, 2008.

[71] FDIC, "Parent Companies of Industrial Banks and Industrial Loan Companies," 85 *Federal Register* 17776, March 31, 2020.

[72] Kobi Kastiel, "Dodd-Frank Moratorium Ends on Bank Charters for Commercial Firms," *Harvard Law School Forum on Corporate Governance*, September 8, 2013, at https://corpgov.law.harvard.edu/2013/09/08/dodd-frank-moratorium-ends-on-bank-charters-for-commercial-firms/.

[73] Zain Tariq and Rachel Stone, "Japan's Amazon Is Latest Tech Heavyweight Seeking Industrial Bank Charter in U.S.," *S&P Global Market Intelligence*, August 12, 2019.

[74] FDIC, "Bank Application Action Search," at https://www.fdic.gov/regulations/applications/actions.html.

- **Nelnet** is primarily a student loan servicer that is also a regional internet provider and a provider of education technology and business services to schools and churches.[75]
- **Square** sells computer hardware and software to businesses that enable electronic payments.[76]
- **Rakuten** is a Japanese online retailer that owns a shopper rewards company in the United States.[77]
- **AmeriNat** processes numerous different loan types.[78]
- **Interactive Brokers**, the filer for Interactive Bank's application, is an online securities trading and investing brokerage firm.[79]
- **SoFi** primarily makes consumer loans for borrowers to consolidate student loan and credit card debts.[80]

Whatever the details of the business models of each applicant, the nonbank nature of the prospective parent companies drew attention from policymakers, industry groups, and the media.[81]

Before the FDIC approved two applications (discussed in the "Latest Developments" section), ILC application outcomes could be interpreted as revealing FDIC unwillingness to approve such applications. All six prospective ILCs withdrew their applications—applications are rarely rejected but are either "returned" or withdrawn by the applicants before rejection—and three of them to date have not refiled. Two that did refile, Square and Nelnet, were eventually approved in March 2020, 922 days and 628 days, respectively, from their initial submissions of their original applications. Rakuten reportedly refiled in late May 2020.[82] By comparison, 53 applications from commercial banks or savings associations on which actions had been taken were submitted from 2016 to 2019. Of these, the FDIC approved 41, and the average time between receipt and approval was 198 days.[83]

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[75] Nelnet, "Our Businesses," at https://nelnetinc.com/businesses/.

[76] Square, "About Us: Investor Relations," at https://squareup.com/us/en/about/investors.

[77] Rakuten, "About Us," at https://global.rakuten.com/corp/about/; and Rekuten USA, "Company Overview," at https://www.rakuten.com/help/article/company-overview-360002116927.

[78] AmeriNat, "About Us," at https://www.amerinatls.com/about-us.

[79] Interactive Brokers, "About the Interactive Brokers Group," at https://www.interactivebrokers.com/en/index.php?f=564.

[80] SoFi, "About Us," at https://www.sofi.com/our-story/.

[81] See ICBA, "ICBA Supports Bill to Close Industrial Loan Company Loophole," press release, November 13, 2019, at https://www.icba.org/news/icba-in-the-news/press-releases/2019/11/13/icba-supports-bill-to-close-industrial-loan-company-loophole; and Brendan Pedersen, "14 years After Walmart, Banks Face a New ILC Bogeyman," *American Banker*, October 24, 2019.

[82] Jon Prior, "Rakuten Refiles with FDIC for ILC Charter," *American Banker*, May 29, 2020, at https://www.americanbanker.com/news/rakuten-refiles-with-fdic-for-ilc-charter.

[83] FDIC, "Bank Application Action Search"; and CRS calculations. Three of the approvals were refiled applications filed earlier in the time period. These approvals came 272 days, 288 days, and 928 days from their initial filing, respectively. The bank that took 928 days to gain approval is a nontraditional bank in that it is an online only bank that focuses on delivering services through mobile device applications. See Penny Crosman, "Varo gets vital FDIC OK for bank charter," *American Banker*, February 10, 2020, at https://www.americanbanker.com/news/varo-gets-vital-fdic-ok-for-bank-charter. This nontraditional technological approach may account for its relatively long application period. Because this bank has a national bank charter, this report does not examine this bank in detail.

In recent years, although Congress had allowed the official moratorium to expire, ILC proponents voiced concerns that the FDIC had in effect maintained an unofficial moratorium on granting ILCs insurance. They argued this was unjustified because ILCs could safely provide credit and other financial services,[84] and the FDIC was potentially noncompliant with the requirement to make timely decisions on applications it faces pursuant to Section 343 of the Riegle Community Development and Regulatory Improvement Act of 1994 (P.L. 103-325).[85] Meanwhile, FDIC leadership generally maintained that the agency would give each ILC application due consideration and would approve those that met relevant requirements.[86]

Latest Developments

Nelnet and Square Approved

The prolonged period without new ILC approvals ended on March 17, 2020, when the FDIC approved two ILCs—Nelnet and Square—for deposit insurance. Nelnet's ILC is to allow the organization to expand its student lending and take deposits.[87] Square's ILC is to allow the organization to increase loans to and accept deposits from its customers.[88]

The FDIC press releases announcing the approvals noted that the companies met the necessary evaluation criteria to receive deposit insurance.[89] In addition, FDIC Chairman Jelena McWilliams's official statements noted that both had been approved under certain conditions, including that the new ILCs must hold significantly higher capital levels than typical banks, and the parent companies must be able to act as sources of strength for the depositories.[90]

Prior to the March 17 FDIC Board meeting, several bank industry associations and consumer advocacy groups sent a joint letter to Chairman McWilliams urging the FDIC not to approve the applications at that time and requesting public hearings on the applications.[91] The groups wanted the FDIC to wait until numerous issues were addressed through a rulemaking process, which the FDIC was about to begin (discussed in "FDIC Proposed Rulemaking"). The issues concerning the

[84] Rachel Witkowski, "Square's Banking Bid Avoids Backlash That Doomed Walmart's," *American Banker*, February 12, 2019.

[85] Letter from Ceila Winslow, vice president of legal and regulatory affairs at the American Financial Services Association, to Robert E. Feldman, executive secretary of the FDIC, February 11, 2019, at https://www.fdic.gov/regulations/laws/federal/2018/2018-deposit-insurance-application-process-3064-za03-c-006.pdf.

[86] For example, U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Nominations of Jelena McWilliams, Marvin Goodfriend, and Thomas E. Workmen*, 115th Cong., 2nd sess., January 23, 2018, S.Hrg. 115-241, p. 19.

[87] FDIC, "Statement by FDIC Chairman Jelena McWilliams on Nelnet Bank," press release, March 18, 2020, at https://www.fdic.gov/news/speeches/spmar1820a.html.

[88] FDIC, "Statement by FDIC Chairman Jelena McWilliams on Square Financial Services," press release, March 18, 2020, at https://www.fdic.gov/news/speeches/spmar1820.html.

[89] FDIC, "FDIC Approves the Deposit Insurance Application for Square Financial Services, Inc., Salt Lake City, Utah," press release, March 18, 2020, at https://www.fdic.gov/news/press-releases/2020/pr20033.html; and "FDIC Approves the Deposit Insurance Application for Nelnet Bank, Salt Lake City, Utah Area," press release, March 18, 2020, at https://www.fdic.gov/news/press-releases/2020/pr20034.html.

[90] FDIC, "Statement by FDIC Chairman Jelena McWilliams on Nelnet Bank," press release, March 18, 2020; and FDIC, "Statement by FDIC Chairman Jelena McWilliams on Square Financial Services," press release, March 18, 2020.

[91] Letter from The Leadership Conference on Civil and Human Rights et al. to Jelena McWilliams, chairman of the FDIC, March 15, 2020, at https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/fdic-ilc-letter-mar2020.pdf.

groups were generally related to how ILC parent companies will be regulated, including whether their nonfinancial activities would be limited and whether they would be subject to capital and liquidity requirements and supervision.[92]

FDIC Proposed Rulemaking

On March 17, 2020, the same day it approved two ILC applicants, the FDIC announced it was issuing and seeking comments on a proposed rule on ILC applicants for insurance.[93] Although the FDIC does not currently have rules requiring specific treatment of ILC applications, it has historically required ILCs to make certain commitments as conditions of approval. The stated purpose of the proposed rulemaking was

> to codify existing practices utilized by the FDIC to supervise industrial banks and their parent companies, to mitigate undue risk to the [Deposit Insurance Fund] that may otherwise be presented in the absence of Federal consolidated supervision … and to ensure that the parent company that owns or controls an industrial bank serves as a source of financial strength.[94]

The FDIC cited the "unique risk profiles" presented by recent ILC applications relative to traditional banks—including lack of supervision of the parent, ILC affiliation with organizations involved primarily in commercial activities, and business models involving innovative technology and strategies—as motivation for the rulemaking. In general, the proposal would require ILCs and their parent companies to enter into certain commitments—which the FDIC has historically required on a case-by-case basis—including consenting to FDIC examination of the parent company, filing annual reports on the parent and its subsidiaries, and maintaining the depository's capital and liquidity at levels determined by the FDIC.[95] The comment period on the proposed rulemaking ended on July 1, 2020.[96] As of this report's date, the rule has not been finalized.

Commenters had mixed reactions to the proposal. ILC proponents expressed approval of the FDIC's apparent willingness to again grant new ILCs deposit insurance through an explicitly codified process, even though they found certain details of the proposed rulemaking's requirements to be unnecessarily restrictive.[97] Although some ILC opponents were encouraged at what they viewed as a strengthening of supervision of ILC parents,[98] they generally asserted that

[92] Letter from The Leadership Conference on Civil and Human Rights et al. to Jelena McWilliams, chairman of the FDIC, March 15, 2020.

[93] FDIC, "FDIC Seeks Comment on Proposal to Ensure Safety and Soundness of Industrial Banks," press release, March 17, 2020, at https://www.fdic.gov/news/press-releases/2020/pr20031.html.

[94] FDIC, "Parent Companies of Industrial Banks and Industrial Loan Companies," 85 *Federal Register* 17772, March 31, 2020.

[95] FDIC, "Parent Companies of Industrial Banks and Industrial Loan Companies," 85 *Federal Register* 17772, 17776-17780.

[96] FDIC, "Parent Companies of Industrial Banks and Industrial Loan Companies: Extension of Comment Period," 85 *Federal Register* 31710, May 27, 2020.

[97] For example, see comment letter from Celia Winslow, senior vice president of the American Financial Services Association, July 1, 2020, at https://www.afsaonline.org/Portals/0/AFSA%20ILC%20Letter%20-%20FINAL.pdf.

[98] For example, see comment letter from Christopher Cole, executive vice president and senior regulatory counsel of the ICBA, July 1, 2020, at https://www.icba.org/docs/default-source/icba/advocacy-documents/letters-to-regulators/fdic-ilc-rule-comment-letter.pdf?sfvrsn=6c292717_0.

the proposal did not address what they perceive as the fundamental issues: allowing blending of commerce and banking and a lack of Federal Reserve supervision.[99]

Rakuten Application and Potential of Future Big Tech

In July 2019, Rakuten, a Japanese corporation, announced it would seek to establish an ILC in the United States.[100] Rakuten was founded in 1997 as an internet retail platform that connected consumers who joined the platform to member retailers. The company expanded and developed what it calls an "ecosystem" business model, wherein it offers a wide range of products and services to meet a broad range of customer demand (e.g., retail shopping services; financial services including banking and insurance; travel tickets and reservations; and entertainment, such as event tickets and digital media). Today, the company has over 70 subsidiaries and claims almost 1.4 billion members in 30 countries.[101] In the United States, it currently offers a shopper rewards program to about 12 million members who receive rebates—which so far have totaled over $1 billion, according to the company—for purchasing from retailers that pay Rakuten a commission.[102] If permitted to establish an ILC, Rakuten plans to offer American members deposit accounts, credit cards, and consumer and business loans.[103] Rakuten might be able use its business model to realize economies of scale and scope in the U.S. market and provide these banking services through convenient, low-cost online delivery.

In addition to the general arguments ILC opponents have made against recent applications, Rakuten's size and business model have raised concerns. Because the company's businesses are highly integrated, relying on selling a multitude of goods and services to members, critics of the ILC application argue the profitability and soundness of the depository would be heavily reliant on the success of the commercial enterprises. This dynamic, they argue, increases the risks associated with the blending of commerce and banking.[104] Another concern hearkens back to the controversies around Walmart and The Home Depot (discussed in the "Controversial Applications and Official Moratoriums: 2005-2013" section, above) but has been reframed in the context of "Big Tech." Rakuten shares some similarities with large American technology companies—such as Amazon, Facebook, Google, and Apple—including having an enormous number of users and the ability to generate and collect vast amounts of data. If such companies were allowed to operate banks, the argument goes, this would combine the long-standing problem of concentrating market power with newer problems associated with privacy, data protection, and data use.[105]

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[99] For examples, see comment letter from Christopher Cole, ICBA, July 1, 2020; and comment letter from Defina Stewart, senior vice president and associate general counsel of the Bank Policy Institute, June 30, 2020, at https://bpi.com/wp-content/uploads/2020/06/BPI-ILC-NPR-Parent-Companies-of-Industrial-Banks-and-Industrial-Loan-Companies-2020.06.30.pdf.

[100] Rakuten, "Announcement for Resolution to Establish a Company for Banking Operations in the United States," press release, July 26, 2020, at https://global.rakuten.com/corp/news/press/2019/0726_06.html.

[101] Rakuten, "About Us," at https://global.rakuten.com/corp/about/.

[102] Rakuten USA, "Company Overview," at https://www.rakuten.com/help/article/company-overview-360002116927.

[103] Rakuten, "Announcement for Resolution to Establish a Company for Banking Operations in the United States," press release, July 26, 2020.

[104] Letter from Hugh Carney, senior vice president of the American Bankers Association, and John Court, senior vice president and general counsel of the Bank Policy Institute, to Kathy Moe, director of the FDIC San Francisco Regional Office, August 30, 2019, at https://www.aba.com/-/media/documents/comment-letter/aba-bpi-oppose-rakuten-ilc-application-083019.pdf.

[105] Letter from Christopher Cole, executive vice president and senior regulatory counsel of the ICBA, to Kathy Moe, director of the FDIC San Francisco Regional Office, June 25, 2020, at https://www.icba.org/docs/default-source/icba/

Rakuten originally applied for FDIC insurance on July 26, 2019. It withdrew this original application on March 19, 2020, two days after the FDIC issued its proposed ILC rule, and it resubmitted its application on May 29, 2020.[106] Reportedly, the company incorporated FDIC feedback on the original application[107] and presumably considered the content of the proposed rule in the resubmitted version.

Selected Possible Legislative Alternatives

Given recent developments, Congress may choose to address ILC policy issues across a spectrum of options. If Congress were to determine the current ILC legal and regulatory framework fundamentally allows too much blending of banking and commerce, it could implement more strict separation. Alternatively, if Congress were to find certain aspects of ILC regulation problematic, it could place targeted new requirements and limits on those aspects. Either of these approaches could include grandfathered provisions for existing ILCs. On the other hand, if Congress determines ILCs are beneficial and well-regulated, it could decide to limit the FDIC's apparent ability to delay ILC application decisions. In addition, if Congress were to require more time to consider ILC issues and pending applications, it could reinstate a temporary moratorium on FDIC insurance approvals for ILCs.

If Congress were to determine ILCs are entirely problematic, one approach it could take would be to make future ILCs ineligible for FDIC insurance. As discussed above, the FDIC guarantee of deposits may raise certain policy concerns involving creating incentives for risk-taking and extending government safety nets to organizations that are commercial enterprises in part. Banning new ILCs from eligibility for FDIC insurance would eliminate these concerns, but at the cost of prohibiting certain potential future credit and financial services providers.

Similar to deposit insurance eligibility, the fact that ILCs are exempt from the definition of a bank under the BHCA is the source of many other concerns related to ILCs and often characterized as a loophole by banks and other ILC critics. Thus, another option for relatively sweeping change would be to amend the BHCA to remove that exemption or to otherwise make the regulatory treatment of ILCs equivalent to banks. In the 116th Congress, S. 2839 takes the latter approach by subjecting ILC holding companies to Federal Reserve supervision and prohibiting commercial firms from becoming ILC holding companies.

Congress could take the more targeted approach of changing aspects of how ILCs and their parents are regulated. For example, it could place limits on the size of the commercial operation of ILC affiliates or the portion of commercial business making up the organization's business as a whole, instead of prohibiting commercial operations entirely. Such measures could reduce risks associated with enabling large companies from exercising market power. If Congress were to determine that lack of supervision of ILC parents is problematic, it could extend the supervisory authorities of the Federal Reserve or the FDIC to ILC parents and specify certain features of BHC regulations that would and would not apply to those parents. Codifying aspects of the FDIC's recent rulemaking into law would be another possible approach along these lines.

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advocacy-documents/letters-to-regulators/comment-letter-to-the-fdic-on-rakuten.pdf?sfvrsn=23a02717_0.

[106] FDIC, "Bank Application Action Search," at https://www.fdic.gov/regulations/applications/ ... ; and FDIC, "Summary of New Deposit Insurance Application Activities," at https://www.fdic.gov/regulations/applications/pending.html.

[107] Jon Prior, "Rakuten Refiles With FDIC for ILC charter," *American Banker*, May 29, 2020, at https://www.americanbanker.com/news/rakuten-refiles-with-fdic-for-ilc-charter.

In the period leading up to the March 2020 approvals, some policymakers had become concerned that the FDIC seemed to be able to indefinitely delay ILCs applications without calling for public comments or initiating the rulemaking process and without a mandate from Congress.[108] Although the FDIC's eventual approval of two ILC applications and its issuance of a notice of proposed rulemaking may have lessened these concerns, Congress may nevertheless determine that the FDIC's authorities and requirements related to granting deposit insurance should be amended to address how the agency assesses and processes ILC applications.

Author Information

David W. Perkins
Specialist in Macroeconomic Policy

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[108] U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Nominations of Jelena McWilliams, Marvin Goodfriend, and Thomas E. Workmen*, 115th Cong., 2nd sess., January 23, 2018, S.Hrg. 115-241, p. 18-19.