National Association of Industrial Bankers
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April 18, 2022

The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing
& Urban Affairs
U.S. Senate
Washington, DC 20510

The Honorable Patrick Toomey
Ranking Member
Committee on Banking, Housing
& Urban Affairs
U.S. Senate
Washington, DC 20510

Dear Chairwoman Brown and Ranking Member Toomey:

The National Association of Industrial Bankers[1] hereby responds to a recent joint trade association letter ("Joint Letter") sent by the Bank Policy Institute (BPI), the Center for Responsible Lending (CRL), the Independent Community Bankers of America (ICBA) and other organizations. This Joint Letter calls on Congress to pass H.R. 5912, The Close the ILC Loophole Act. This letter will correct the misrepresentations made in the Joint Letter and provide you with an accurate story about Industrial Loan Corporations (ILCs).

ILCs are among the safest and soundest banks in the U.S. financial system, and they operate in a safe and regulated manner. Some incumbent banks are looking to stifle the competition brought by ILCs by asking Congress to eliminate ILCs, which are very important to the customers they serve and represent only 25 institutions and 1.4 percent of domestic banking assets.

We ask you to look at the facts, which do not support the need to change this regime which was intentionally created by Congress and is well regulated by state and federal regulators. The concern is based on a speculative future risk that can be mitigated by alternative and more appropriate actions.

The Joint Letter offers no documentation and ignores compelling research regarding ILCs.

The Joint Letter misrepresents the risk posed by ILCs, provides no documentation verifying their claims, and ignores academic research which undermines the allegations. For example, renown scholars Dr. James R. Barth and Dr. Yanfei Sun released a comprehensive study Source of Strength and Consolidated Supervision: A Comparative Assessment of Industrial Banks and Commercial Banks, July 2021.

After an exhaustive review of data, Drs. Barth and Sun documented the following:

[1] First chartered in 1910, industrial banks operate under a number of titles – industrial banks, industrial loan banks, industrial loan corporations and thrift and loan companies. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the U.S. economy. NAIB members are chartered in California, Nevada and Utah.

1. "The data do not support the view that consolidated supervision of bank holding companies by the Federal Reserve is superior to oversight of ILCs and their parent companies by the FDIC and state regulators."
2. "To fulfill their regulatory responsibilities, the FDIC and state regulators use essentially the same supervisory tools as the Federal Reserve employs to regulate a bank holding company."
3. "Nor do we find that [ILC] bank holding companies are more likely to contribute to financial instability than bank holding companies."

The most telling statistic of ILCs is that the FDIC-insured industrial banks in Utah and Nevada have for the past 35+ years been among the best capitalized, most profitable, safest and soundest group of banks insured by the FDIC. Nothing in the history of the ILCs provides any basis to argue that they present a significant risk to the FDIC, the banking industry, or the nation's economy.

ILCs are highly regulated by federal and state regulators

The Joint Letter incorrectly asserts that the FDIC does not have sufficient authority to regulate ILCs, their affiliates or their parent companies. The FDIC has broad authority over both ILCs and their parent companies to take any and all actions necessary to protect the bank, its depositors and the deposit insurance fund. The FDIC has frequently affirmed its authority to regulate the industrial banks and their transactions and relationships with their parents and affiliates (including in testimony of former FDIC Chairman Martin Gruenberg made this clear in response to questions from the Senate Banking Committee).

The FDIC uses the same examination manuals for ILCs that it does for other state-chartered banks to scrutinize ILCs for Safety and Soundness, Compliance, and Community Reinvestment Act (CRA) requirements. ILCs are rated using the same FDIC CAMEL rating system as applied to other banks.

Recent Rulemaking has already provided the refresh to ensure ILC regulations extend appropriately to parent companies

The FDIC's recent rulemaking to codify existing regulatory practices further highlights the agency's ample authority to ensure that the parent company of an ILC, be it financial or commercial, does not pose a risk to the institution or to the U.S. financial system. Both the state regulators and the FDIC have the authority to examine for compliance with Federal Reserve Act Sections 23A and 23B and ensure that the ILC and its parent interact in a safe and sound manner and the ILC has adequate compliance management systems to address affiliate transactions. The regulators can also require that the parent serve as a source of strength to the bank should it become distressed. They can examine the parent company's records and management of the ILC as needed should concerns arise. Finally, as former Chairman Gruenberg noted, the FDIC and the appropriate state banking regulator can limit the activities an ILC can engage in with a parent or affiliate if they are concerned about those activities' impact on the institution.

ILCs are an intentional creation of Congress, not a loophole

The Joint Letter erroneously asserts that ILCs operate under a "loophole" that exempts them from the Bank Holding Company Act (BHCA). The ILC exemption from the BHCA is not a loophole, it is an intentional creation enacted by Congress as part of the Competitive Equality Banking Act of 1987 (CEBA). In the 35 years since the enactment of CEBA, Congress revised the regulatory structure for our nation's banks multiple times and mandated multiple studies of ILCs to determine

if changes to those laws were also needed but repeatedly chosen to leave the regulatory structure for ILCs intact. Congressional intent in this area is clear.

For example, over the past four decades the FDIC has twice imposed moratoriums on grants of deposit insurance to new ILC charters for the express purpose of allowing Congress to review the exemption for ILC parents and affiliates from the Bank Holding Company Act. The moratorium specified in the Dodd-Frank Act also required the GAO to study the issue and report to Congress 18 months before the moratorium expired. Congress allowed both moratoriums to expire without choosing to end the ILC exemption from the BHCA. This is no doubt due in large part to the strong performance of ILCs over that entire period.

ILCs are among the safest, strongest financial institutions in the nation

A review of the history of ILCs clearly and unequivocally demonstrates the spurious nature of the allegations in the Joint Letter that ILCs present a safety and soundness risk to our financial system. ILCs are now and for the past 35 years have consistently been better capitalized and more profitable than their commercial banking peers. Recent FDIC call report data show that in comparison to commercial banks, ILCs overall, and especially commercially owned ILCs, are better capitalized, have a higher return on assets (ROA), and are generally more profitable than banks in general.[2]

As of September 30, 2021, the US banking industry had $23.3 trillion in assets and $2.3 trillion in capital, resulting in a capital-to- assets ratio of 10.1%. Industrial banks have $191 billion in assets and capital of 22.6 billion, resulting in a capital-to-assets ratio of 11.8%. Commercially owned industrial banks have $18.5 billion in assets and $3.1 billion in capital, resulting in a capital-to-assets ratio of 16.9%.[3]

For the year ending December 31, 2021 the banking industry reported net income totaling $232.8 billion, resulting in an annualized return on assets (ROA) of 1.27 percent. Industrial banks' net income for the period totaled $9.23 billion, resulting in an annualized ROA of 3.54 percent. Commercially owned industrial banks reported net income totaling $293.7 million during that period, resulting in an annualized ROA of 2.01 percent. These numbers are not just a snapshot in time. ILCs have outperformed other banks in both ROA and capital-to-assets ratios for the past 35 years.[4]

Furthermore, of the $23.7 trillion in total banking assets as of December 31, 2021, ILCs account for only $216 billion, or less than 1% of total banking assets. Combining all ILC assets would not equal a top 12 bank in the United States. The numbers speak for themselves: ILCs pose no threat to the banking system.

The Joint Letter irresponsibly states that industrial banks failed during the Great Recession. Only one industrial bank failed at that time compared to 529 FDIC insured banks owned by a Federal Reserve regulated bank holding company. In fact, during the Great Recession many ILCs grew

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[2] "Industrial banks: Challenging the Traditional Separation of Commerce and Banking." James R. Barth and Yanfei Sun https://doi.org/10.1016/j.qref.2019.10.001
[3] https://www.industrialbankers.org/resources-2/ilc-safety-and-soundness-q3-2021
[4] https://www.industrialbankers.org/resources-2/ilc-safety-and-soundness-q3-2021

during that period while most commercial banks shrank. This was because most ILCs with a diversified parent had access to additional capital while most commercial banks did not.[5]

Fear of Big Tech Banking is understandable but addressable with less drastic means than removing the availability of the ILC charter

A report by the Financial Stability Board summarizes the concerns many share about "Big Tech" expanding into banking.[6] This apprehension of their entry into financial services is understandable. But existing laws make such steps impractical for many of these companies. For instance, Sections 23A and 23B of the Federal Reserve Act impose restrictions on banks (including ILCs) as to loans to, or purchases of assets from, and certain other transactions with, affiliates.

Further, Big Tech companies that are not merchants and accumulate data for sale to third parties are unlikely to change their operations to meet the significant privacy requirements that banks (including ILCs) must satisfy. Nevertheless, it may be prudent for the GAO to perform a study of the ability of “Big Tech” to own and operate any kind of bank and to consider legislative actions that are tailored to this risk.

ILCs should continue to be able to serve American consumers with safe innovative financial services

In summary, ILCs are among the safest and soundest banks in the U.S. system, and they do not create systemic risk. We ask you to look at the facts, which make clear that ILCs themselves are not a threat to the banking system, the U.S. economy, or consumers.

Our members are willing to work with Committee members and others to develop legislation that mitigates the risk of Big Tech obtaining any type of bank charter.

Thank you for your time and consideration.

Sincerely,

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[5] A New Look at the Performance of Industrial Loan Corporations, James R. Barth and Yanfei Sun; pages 31-32; https://d30i16bbj53pdg.cloudfront.net/wpcontent/uploads/2021/07/ILC_REPORT_BARTH_2018.pdf

[6] https://www.fsb.org/2019/12/bigtech-in-finance-market-developments-and-potential-financial-stability-implications/