From: Robert Rutkowski
Sent: Wednesday, October 16, 2024 3:07 PM
To: Public Information; Comments
Subject: FDIC Effort to Regulate Industrial Loan Banks

Record Number: DOC24/9094

Martin J. Gruenberg
Chair
Federal Deposit Insurance Corporation
Public Information Center
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Re: FDIC Effort to Regulate Industrial Loan Banks

Dear Chair:

AFREF, Consumer Federation of America, Prof. Arthur Wilmarth, Jr. and Center for Responsible Lending submitted a comment to the Federal Deposit Insurance Corporation supporting the effort to strengthen the oversight of industrial loan companies (ILCs). These ILC charters provide a regulatory exemption that blurs the line between banking and commerce, sidesteps traditional banking supervisory regulation and oversight, and poses safety and soundness risks to the ILCs, their corporate parents, consumers, and the financial system. The proposed rule would heighten scrutiny of new ILCs or attempts to take over existing ILCs that will more fully consider the unique risks of these banks.

Th comment makes additional recommendations to strengthen the proposed rule further.

Notice of proposed rulemaking: Parent Companies of Industrial Banks and Industrial Loan Companies, RIN-3064-AF88
https://gcc02.safelinks.protection.outlook.com/?url=https%3A%2F%2Fourfinancialsecurity.org%2Fwp-content%2Fuploads%2F2024%2F10%2FILC-Parent-Companies-RIN-3064-AF88-CFA-AFR-CRL-Wilmarth.pdf&data=05%7C02%7CComments%40FDIC.gov%7C32fd8d8468624a9ede5d08dcee15d846%7C26c83bc931c14d77a5230816095aba31%7C0%7C0%7C638647025725869691%7CUnknown%7CTWFpbGZsb3d8eyJWIjoiMC4wLjAwMDAiLCJQIjoiV2luMzIiLCJBTiI6Ik1haWwiLCJXVCI6Mn0%3D%7C0%7C%7C%7C&sdata=44Qemh2n2H4AkOywoC%2F%2F5N%2FXOfsRdIQ8F%2FVIqht1Bq4%3D&reserved=0

Yours sincerely,
Robert E. Rutkowski

October 11th, 2024

James P. Sheesley
Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th St., NW
Washington, DC 20249

RE: Notice of proposed rulemaking: Parent Companies of Industrial Banks and Industrial Loan Companies, RIN-3064-AF88

Dear Mr. Sheesley:

Consumer Federation of America, Americans for Financial Reform Education Fund, Prof. Arthur E. Wilmarth, Jr. the Center for Responsible Lending appreciate the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC's) proposed rulemaking to improve the oversight of industrial banks, industrial loan companies, and their parent corporations.[1] The proposed rule would strengthen the oversight of industrial loan companies and industrial banks (hereafter, industrial banks) that operate under a special exemption to federal banking law, which, as currently interpreted by the FDIC, allows a commercial company to own an FDIC-insured industrial bank without being subject to the same oversight, prudential standards, and regulatory limitations designed to prevent the mixing of banking and commerce that Congress has wisely established for all other categories of FDIC-insured banks.

The proposed rule provides enhanced consideration of industrial bank applications for changes of control, mergers, de novo charters, and approvals of deposit insurance so that the FDIC can more fully consider the unique risks of industrial banks and their relationships with their parent companies and affiliates. The proposed rule also provides needed clarity as to which parent companies of industrial banks are covered by the applicable regulations (12 C.F.R. Part 354) during the FDIC's consideration of applications for changes of control, mergers, or charter conversions involving industrial banks.

The original industrial banks were small, limited-purpose institutions used by companies to provide small loans to manufacturing workers who could not otherwise receive affordable credit. However, since the industrial bank loophole was created in 1987, larger commercial companies — including technology firms — have sought industrial bank charters to access the U.S. banking system and to exercise the powers to accept FDIC-insured deposits, make loans, evade state usury laws, and process payments without consolidated supervision. The lack of comprehensive and consolidated supervision allows excessive risks to accumulate in industrial banks and their parent companies and affiliates without effective oversight by any federal regulator.

The proposed rule is an important step toward improving oversight of industrial banks and their parent companies and affiliates as well as reducing the safety and soundness risks posed by industrial banks and

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[1] FDIC, Notice of Proposed Rulemaking. Parent Companies of Industrial Banks and Industrial Loan Companies. RIN 3064-AF88. 89 Fed. Reg. No. 155. August 12, 2024, at 65556 et seq.

their parent companies and affiliates to the financial system, consumers, and taxpayers. This comment makes additional recommendations to strengthen the proposed rule further.

SUMMARY

I. A rebuttable presumption against approving applications involving shell and captive industrial banks would provide additional protection against the significant risks created by such applications. By establishing this new rebuttable presumption, the FDIC would increase the effectiveness of its decision-making process for such applications.

- *Regulators have few options to prevent distressed shell or captive industrial banks from failing.*
- *Shell and captive industrial banks are vulnerable to contagion effects from the parent company's difficulties or failure.*
- *Shell and captive industrial banks benefit their parent companies but often do not create benefits for the public.*

II. The FDIC should amend the definition of "covered company" to close several loopholes. The FDIC should clarify the definition of "covered company" to ensure that the FDIC can review and assess the risks of all applications involving changes in control of industrial banks or conversions of other types of depository institutions into industrial banks.

- *The FDIC should revise the definition of "covered company" to include instances where a chartered financial institution controlled by a parent company applies to convert its charter to an industrial bank charter.*
- *The FDIC should clarify that a change in control of a parent company that controlled an industrial bank before April 2021 will require that company (and any company that controls that company) to comply with 12 C.F.R. Part 354.*

III. The FDIC should establish an additional rebuttable presumption against approving applications involving industrial banks controlled by parent companies that are not "predominantly engaged in financial activities."

- *Ownership or control of industrial banks by commercial firms violates the fundamental U.S. policy of separating banking and commerce.*
- *The emergence of embedded finance represents a secular shift to new forms of combinations that threaten to undermine the separation of banking and commerce.*
- *The FDIC should adopt a rebuttable presumption against approving applications involving industrial banks controlled by companies not "predominantly engaged in financial activities."*
- *The most straightforward and effective way for the FDIC to uphold the longstanding U.S. policy of separating banking and commerce would be to adopt a regulation providing that the FDIC will not approve applications involving industrial banks controlled by companies that are not "predominantly engaged in financial activities."*

IV. Shell and captive industrial banks' narrow offerings of credit and deposit services raise serious concerns about their ability to meet the convenience and needs of the communities they are obligated to serve.

- *While industrial banks are subject to community reinvestment obligations, in practice, they are held to lower standards than most other FDIC-insured depository institutions.*

- *In practice, credit and deposit service activities offered by most industrial banks are nationwide in scope and are not focused on the local communities they are obligated to serve.*
- *Some industrial banks have strayed from their mission and offer damaging high-cost credit products to vulnerable consumers and small business owners.*
- *Shell and captive industrial banks are designed to serve narrow audiences targeted by their parent companies and are not structured to meet the conveniences and needs of the communities where they do business. We strongly support the FDIC's proposal to apply enhanced scrutiny to the ability of shell and captive industrial banks to meet the convenience and needs of the communities they are obligated to serve.*

DISCUSSION

I. A rebuttable presumption against approving applications involving shell and captive industrial banks would provide additional protection against the significant risks created by such applications. By establishing this new rebuttable presumption, the FDIC would increase the effectiveness of its decision-making process for such applications.

We strongly support the FDIC's intention to identify and apply enhanced scrutiny to shell and captive business models that make industrial banks overly dependent on their parent companies. Industrial banks that depend heavily on their parent companies for financial and operational support are likely to be vulnerable to financial distress or economic shocks that befall the parent or affiliates because those adverse developments can compromise capital or liquidity levels, constrain earnings prospects, and undermine safety and soundness. These concerns are especially pronounced when the industrial bank receives all or most of its business revenues through the parent or affiliates and/or receives key operational or support services from the parent such that a parent's financial distress would severely compromise the industrial bank's business operations.

Parent companies are required to serve as a "source of financial strength" for their bank subsidiaries under 12 U.S.C. § 1831o-1. By permitting the FDIC to consider how a parent company's activities could potentially compromise the sustainability of its industrial bank subsidiary, the FDIC's proposed new framework for evaluating applications involving shell and captive industrial banks would provide a more nuanced and effective method for assessing the parent-subsidiary relationship.

Since the FDIC ended its moratorium on new industrial bank approvals in 2020, most of the applications for new industrial bank charters would have created shell or captive industrial banks that are dedicated exclusively to supporting the activities of their corporate parents.[2] Some of the recent applications have been filed by companies with significant political influence. While the FDIC has exclusive authority to approve applications for deposit insurance, creating a rebuttable presumption would support the agency's regulatory independence as well as its ability to reject applications that would impose significant risks on the Deposit Insurance Fund (DIF) and/or create significant threats to the stability of the U.S. banking system.

As the FDIC rightly pointed out in its proposal:

> Shell and captive bank business models create potentially significant supervisory concerns for industrial banks. The level of concern with these business models is inherently heightened due to the substantial reliance on the parent company or its

[2] Nine industrial bank applications have been filed since the FDIC lifted its moratorium in 2020. Of those applications, six were withdrawn, one was returned as substantially incomplete, one was approved, and one is pending. 89 Fed. Reg. at 65558.

> affiliates, particularly with respect to the primary business operations of the industrial bank. . . .
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> In shell or captive structures, the industrial bank's operations and condition may be vulnerable to any financial distress or operational disruptions at the parent company or any affiliates that provide key services to the industrial bank. The heavily integrated relationship between the industrial bank and the parent organization results in significant concentration risks that are typically not present in traditional community bank operating structures. Further, the industrial bank generally has limited or no ability to operate independently from the parent organization and, as discussed below, lacks franchise value on a standalone basis.[3]

Regulators have few options to resolve failed shell or captive industrial banks.

Captive or shell industrial banks present unique resolution challenges for the FDIC because the industrial bank's dependency and close integration with the parent company may present hurdles to the most common and lower-cost resolution procedures. It would be difficult to arrange a sale of assets of a shell or captive industrial bank because those assets are intrinsically tied to the assets and operations of its parent company. Thus, for example, the value of the shell or captive is closely tied to the branding, client relationships, personnel, and shared business systems of the parent company. As the FDIC correctly observed in its proposal, the viability of an industrial bank that is part of a shell or captive business model depends on "ongoing support from the parent organization. In such cases, financial or operational stress at the parent company or any of its affiliates reduces the franchise value of the industrial bank in the event of failure and complicates its resolution. . . . [T]he loss of critical support services previously provided to the industrial bank by its parent organization or affiliates would pose a potentially significant challenge in a resolution scenario, as the parent or affiliated entities may no longer be able to fulfill their obligations under existing service agreements."[4]

Thus, a shell or captive business model that closely integrates the business operations of an industrial bank with its parent company is likely to undermine efforts to resolve the failure of that bank. An industrial bank whose operations are tightly interwoven with the activities of its parent company would almost certainly struggle to survive if a crisis occurred at its parent corporation. It would also be more difficult, all else being equal, to arrange a sale of the assets of an industrial bank if its operations are closely tied to the activities of the parent company.[5] The dependency of shell and captive industrial banks on their parent companies is likely to foreclose the most common purchase and assumption or bridge bank resolution processes, in which the FDIC sells the assets and deposit liabilities of a failed bank to another insured depository institution. Instead, the FDIC may be forced to pay off insured depositors and arrange piecemeal asset sales, which are more cumbersome and costly to the Deposit Insurance Fund.

Shell and captive industrial banks are vulnerable to contagion effects from their parent company's difficulties or failure.

As stated above, parent companies are required to serve as a "source of financial strength" for their subsidiary industrial banks under 12 U.S.C. § 1831o-1. Parent companies are likely to lose their ability to support their subsidiary industrial banks and are likely to expose those banks to serious risks when parent companies engage in speculative and highly cyclical businesses. Those risks are especially high if the

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[3] 89 Fed. Reg. at 65561.

[4] 89 Fed. Reg. at 65563.

[5] *See* 89 Fed. Reg. at 65563-64 nn.57-59 (discussing the problems that the FDIC encountered in resolving the failures of Advanta, a Utah industrial bank and a federal savings association owned by Lehman Brothers, and NextBank, N.A. due to the heavy reliance of those FDIC-insured institutions on financial and operational support provided by their bankrupt parent companies).

parent company's business cycles are strongly correlated with adverse changes in macroeconomic factors. Such risks act as contagion factors that compromise the viability of industrial banks.

Several large corporate owners of industrial banks failed or were rescued by the federal government during the global financial crisis of 2007-09, and the total number of industrial banks fell from 58 in 2007 to 23 today. Four very large corporate owners of industrial banks—General Motors Acceptance Corp. (GMAC), Merrill Lynch, Goldman Sachs, and Morgan Stanley—received huge bailouts from the federal government to prevent their failures. A fifth major industrial bank owner—GE Capital—encountered very serious liquidity problems during the crisis and received extensive financial assistance from federal agencies. A sixth corporate industrial bank owner—CIT Group—failed in 2009, thereby wiping out $2.3 billion of taxpayer-funded assistance that CIT received from the federal government's Troubled Asset Relief Program (TARP).[6] The four largest securities firms before the crisis (Merrill Lynch, Goldman Sachs, Morgan Stanley, and Lehman Brothers) operated Utah-based industrial banks and other FDIC-insured depository institutions; today only two of the firms survive independently (Goldman and Morgan) and their industrial banks were converted into commercial banks.

In 2008, GMAC held over $200 billion of assets and owned a large Utah industrial bank with $33 billion of assets and $17 billion of deposits. GMAC was the primary source of financing for dealers and retail customers who purchased and leased General Motors (GM) vehicles. In 2007 and 2008, GMAC suffered crippling losses from its subprime mortgage lending business and additional losses from its auto lending business. To prevent GMAC's failure, the Federal Reserve (Fed) approved GMAC's emergency conversion into a bank holding company in December 2008. Federal agencies provided over $40 billion of financial assistance to GMAC in the form of TARP capital infusions, FDIC debt guarantees, and purchases of commercial paper and emergency loans by the Fed. The federal government bailed out GMAC so that it could provide financing for vehicle sales and leases made by GM and Chrysler after federal agencies rescued both automakers.[7] The federal government acquired a nearly three-quarter (73.8 percent) stake in GMAC's bank holding company which was renamed Ally Financial; the federal government sold the last of its Ally stock at the end of 2014.[8]

Merrill Lynch held almost $900 billion of assets and was the third-largest U.S. securities broker-dealer in 2008. Merrill Lynch owned a Utah industrial bank with $60 billion of deposits as well as a federal savings association with $20 billion of deposits. Merrill Lynch suffered huge losses from its involvement in high-risk activities, including subprime lending and securitization. To avoid collapse, Merrill Lynch agreed to be acquired by Bank of America—at the urging of federal regulators—during "Lehman weekend" in September 2008. Federal agencies subsequently provided more than $300 billion of financial assistance to Bank of America and Merrill Lynch in the form of TARP capital infusions, asset and debt guarantees, purchases of commercial paper, and emergency Fed loans. A significant portion of that enormous rescue package covered Merrill Lynch's losses. Merrill Lynch would have failed, and it is doubtful whether Bank of America could have survived, without the federal government's bailout.[9]

Goldman Sachs and Morgan Stanley, the two largest U.S. securities broker-dealers, each held $1 trillion or more of assets in 2008. Goldman Sachs and Morgan Stanley each owned a Utah industrial bank with over $25 billion of assets. Goldman Sachs and Morgan Stanley—like Merrill Lynch—were heavily involved in high-risk, subprime-related activities during the boom leading to the global financial crisis. A week after Lehman Brothers failed, the Fed approved applications by Goldman Sachs and Morgan

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[6] Arthur E. Wilmarth, Jr., "The FDIC Should Not Allow Commercial Firms to Acquire Industrial Banks," 39 *Banking & Financial Services Policy Report* No. 5 (May 2020), at 1, 4-6, https://ssrn.com/abstract=3613022.
[7] *Id.* at 5.
[8] Webel, Baird and Bill Canis. Congressional Research Service. "Government Assistance for GMAC/Ally Financial: Unwinding the Government Stake." Report No. R41846. January 26, 2015.
[9] Wilmarth, *supra* note 6, at 5.

Stanley for emergency conversions into bank holding companies to ensure their survival. Federal agencies provided financial support totaling over $300 billion to Goldman Sachs and Morgan Stanley through TARP capital infusions, FDIC debt guarantees, and purchases of commercial paper and emergency loans by the Fed. Goldman Sachs and Morgan Stanley almost certainly would have failed without the federal government's support.[10]

GE Capital Corporation was a subsidiary of General Electric (GE) and engaged in a wide range of financial activities. GE Capital held almost $700 billion of assets in 2008, including a Utah industrial bank. GE Capital experienced severe liquidity problems after Lehman Brothers failed, including great difficulty in selling short-term commercial paper to fund its operations. The Fed responded by purchasing $16 billion of GE Capital's commercial paper, and the FDIC guaranteed over $70 billion of GE Capital's newly-issued debt securities. GE Capital would have faced very serious funding challenges without the federal government's extensive financial assistance.[11]

CIT Group was a large nonbank financial firm that provided commercial lending and leasing services to small- and medium-sized businesses, as well as subprime mortgages and student loans to consumers. CIT held $80 billion of assets in 2008, including a Utah industrial bank. In December 2008, the Fed approved CIT's application for an emergency conversion into a bank holding company after CIT recorded large losses and experienced severe funding problems. CIT also received a $2.3 billion capital infusion from TARP. However, CIT's problems continued, and it filed for bankruptcy in November 2009. CIT's failure wiped out the federal government's entire TARP investment in the firm.[12]

Thus, the federal government provided massive bailouts to rescue GMAC, Merrill Lynch, Goldman Sachs, Morgan Stanley, and GE Capital during the financial crisis. In addition, the federal government lost its entire taxpayer-funded investment in CIT. Those bailouts and losses illustrate the enormous systemic risks that are likely to arise when large, complex nonbank corporations acquire industrial banks and combine the operations of those industrial banks with other high-risk activities that are subject to sharp downturns during adverse macroeconomic cycles.

As shown by the foregoing examples, the FDIC should be greatly concerned whenever a parent company intends to rely on financing provided by its subsidiary industrial bank to support its commercial business activities, which can create moral hazard and safety and soundness concerns. For example, Ford Motor Company applied in 2022 for an industrial bank charter for its Ford Credit nonbank financing subsidiary. Ford provides loans to car buyers and dealerships through Ford Credit. The profits of Ford Motor Company's automobile division are cyclical and highly correlated with unemployment, interest rate levels, and other macroeconomic factors. Ford is seeking an industrial bank charter for Ford Credit so that Ford Credit can obtain funding at much cheaper prices by offering FDIC-insured deposits.

In 2020, the auto desk at the *Detroit News* summarized the highly dependent relationship between Ford Motor and Ford Credit: "Ford Credit, the lending arm that's become accustomed to propping up the company in good times and bad, now generates about half the automaker's profit, up from 15 percent to 20 percent in the past…The second-largest U.S. automaker would be far worse off without its Ford Motor Credit Co. unit, [which has been] effectively funding turnaround efforts by routinely borrowing in the debt markets and paying a dividend back to the parent company."[13] The article also cited an analyst who

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[10] *Id.*
[11] *Id.*
[12] *Id.*
[13] Smith, Molly, and Keith Nauhgton. "Ford's Lending Arm Is Generating More Profit than Ever." *Detroit News*, February 3, 2020. https://www.detroitnews.com/story/business/autos/ford/2020/02/03/fords-lending-arm-generating-profit-ever/41133523/.

stressed how much Ford Motor Company relies on its Ford Credit division to cover the cost of maintaining its dividend.

The Ford-Ford Credit example shows how a captive industrial bank could become a captive source of funding to its commercial parent company—an outcome that is exactly the opposite of the parent company's obligation to serve as a source of financial strength to its subsidiary industrial bank. Given the previous failures of parent companies of industrial banks, like GMAC and CIT, that relied heavily on financing provided by their industrial bank subsidiaries, applications like Ford's should not be approved. We strongly support the rebuttable presumptions contained in the FDIC's proposed amendments to 12 C.F.R. § 354.6(c), which would weigh heavily against approval of such applications.

In 2020, the FDIC approved Square's application for an industrial bank charter even though the company had only reported a profit once in the prior eight years.[14] That application should not have been approved, and the proposed amendments to 12 C.F.R. § 354.6(a)-(c) would hopefully preclude the approval of a similar application in the future.

Shell and captive industrial banks benefit their parent companies but often do not create benefits for the public.

As indicated above, a nonbank parent company like Ford may attempt to lower its weighted average cost of capital by acquiring an industrial bank, thereby giving the parent company access to low-cost funding through the acceptance of FDIC-insured deposits. Without the benefit of owning an FDIC-insured depository institution, parent companies must finance their operations by obtaining bank loans or issuing debt and equity securities. Bank loans and debt securities are significantly more expensive funding sources than deposits. Issuing equity securities costs even more in terms of funding dividend payments (which are not tax-deductible) and diluting the interests of existing equity owners. During times of lower interest rates, acquiring a depository institution could reduce a private company's cost of capital fourfold or more. The magnitude of that benefit would depend on the amount of deposits the subsidiary industrial bank could attract as well as the market's perception of the riskiness of that bank and its parent company. In addition to the benefits of insured deposit taking, industrial banks can access the Fed's emergency lending programs for depository institutions and Fed-supervised payment systems for checks, debit and credit cards, online and mobile payments, and wire transfers. In any case, the benefits of owning an FDIC-insured industrial bank are likely to be very significant for the parent company.

In contrast, no discernible benefits will accrue to the public from shell or captive industrial bank structures that are primarily designed to narrowly serve the interests of their parent companies. Industrial banks do not have any obligation to offer higher rates on their deposits or lower rates on their loans than other banks offer. When a nonbank parent company acquires a shell or captive FDIC-insured industrial bank and uses it to provide financing to its customers as a substitute for its prior captive nonbank finance company, the parent company is not required to provide any additional benefits to consumers in the form of higher-yielding deposits or lower-cost loans. Thus, the benefits to the public of shell or captive industrial banks are highly doubtful, while the risks to the stability of our financial system and the potential costs to the DIF are large and undeniable, as the global financial crisis of 2007-09 demonstrated.

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[14] Statista. "Block Net Income, per year, from 2012 to 2023." Accessed October 2, 2024. https://www.statista.com/statistics/593871/square-annual-net-income-loss/.

II. The FDIC should amend the definition of "covered company" to close several loopholes. The FDIC should clarify the definition of "covered company" to ensure that the FDIC can review and assess the risks of all applications involving changes in control of industrial banks or conversions of other types of depository institutions into industrial banks.

We strongly support the FDIC's proposal to clarify the scope of 12 C.F.R. Part 354 by amending 12 C.F.R. § 354.2(a) to provide that "covered companies" include companies that acquire control of FDIC-insured industrial banks through mergers, change in control transactions, approvals of deposit insurance applications, or conversions of savings association charters to industrial bank charters. The proposed amendments to Section 354.2(a) are needed to ensure that all companies acquiring control of FDIC-insured industrial banks must enter into written agreements and commitments with the FDIC and comply with the other provisions of Part 354. These written agreements covering safety and soundness, managerial independence, capital and liquidity, and contingency planning are essential to the FDIC's ability to evaluate and monitor the impact of the parent on the industrial bank and its operations.

The FDIC should revise the definition of "covered company" to include instances where a chartered financial institution controlled by a parent company applies to convert its charter to an industrial bank charter.

The FDIC should revise its covered company definition to include any depository institution's conversion into an industrial bank. Earlier this year, a chartered savings association received approval for an application to change its charter to an industrial bank. All such conversions should be subject to Part 354, as specified in the FDIC's proposed amendment to Section 354.2(a)(3). In addition, the FDIC should clarify that its proposed amendment to Section 354.2(a)(4) would apply to any transaction in which an uninsured depository institution or a credit union converts to an industrial bank charter and applies to the FDIC for deposit insurance in connection with that conversion.

The FDIC should clarify that a change in control of a parent company that controlled an industrial bank before April 2021 will require that company (and any company that controls such a company) to comply with 12 C.F.R. Part 354.

We strongly support the FDIC's proposed amendment to Section 354.2(b), which would clarify that a company that controlled an existing FDIC-insured industrial bank prior to April 2021 must comply with 12 C.F.R. Part 354 if a change in control of such company occurs after April 2021. The proposed amendment should also provide that any company that acquires control of such company after April 2021 must comply with Part 354.

III. The FDIC should adopt an additional rebuttable presumption against approving applications involving industrial banks controlled by companies that are not "predominantly engaged in financial activities."

Ownership or control of industrial banks by commercial firms violates the fundamental U.S. policy of separating banking and commerce.

Congress has long prohibited combinations of banking and commerce because of the great risks posed by such combinations to the financial system and the economy. It is a longstanding and fundamental principle of U.S. banking policy that banking should be separated from commerce. Commercially-owned banks have historically extended unsound loans to affiliates, denied services to competitors, and engaged in imprudent activities to promote commercial businesses that can intensify moral hazard and increase the

risks of financial distress, failure, and financial contagion.[15] In 1987, when Congress created an apparent exception to that principle by exempting industrial banks from the definition of "bank" in the Bank Holding Company Act (BHC Act), it did so without indicating any intention to undermine its longstanding policy of separating banking and commerce.

Section 4 of the BHC Act, 12 U.S.C. § 1843, is the cornerstone of our nation's policy of separating banking and commerce. With narrowly limited exceptions, Section 1843 prohibits companies that own or control FDIC-insured banks from engaging in commercial activities or from owning commercial enterprises. The central purpose of Section 1843 is to prevent the formation of banking-and-commercial conglomerates that would pose grave dangers to our society, financial system, and economy, including (1) hazardous concentrations of economic and financial power and political influence, (2) toxic conflicts of interest that would seriously impair the ability of banks to act objectively in providing credit and other financial services, and (3) serious risks of systemic contagion between the financial and commercial sectors of our economy, which could inflict substantial losses on the federal "safety net" for banks—including the DIF, the Fed's discount window, and the Fed's payment system guarantees.[16]

Under 12 U.S.C. § 1841(c)(2)(H), which was enacted in 1987, industrial banks chartered by several states are exempted from the definition of "bank" under the BHC Act if they do not accept demand (checking) deposits from for-profit business firms. Senator Jake Garn (R-Utah) sponsored that exemption, which Congress included in the Competitive Equality Banking Act of 1987 (CEBA). When the exemption was enacted in 1987, industrial banks were primarily small, locally focused institutions that offered deposit and credit services to lower- and middle-income consumers. In 1987, commercial firms did not control any industrial banks. Industrial banks did not become generally eligible for federal deposit insurance until 1982, and the total assets of industrial banks in 1987 were only $4.2 billion.[17]

CEBA reaffirmed and strengthened Congress's policy of separating banking and commerce by closing the "nonbank bank loophole." During the 1980s, many commercial firms used the nonbank bank loophole to acquire FDIC-insured banks that either did not accept demand (checking) deposits or did not make commercial loans. CEBA closed that loophole by expanding the definition of "bank" in the BHC Act to include all "banks" that accept FDIC-insured deposits.[18] The Senate committee report on CEBA declared that "[n]onbank banks undermine the principle of separating banking and commerce, a policy that has long been the keystone of our banking system…The separation of banking from commerce helps ensure that banks allocate credit impartially, and without conflicts of interest." The Senate committee report also explained that CEBA's closing of the nonbank bank loophole would "minimize the concentration of financial and economic resources" and enhance "the safety and soundness of our financial system."[19] During the floor debates on CEBA, members of Congress emphasized that the nonbank bank loophole must be closed to maintain the policy of separating banking and commerce and to ensure parity of regulatory treatment for all companies that controlled FDIC-insured banks.[20]

CEBA's legislative history did not include any discussion of the purpose or anticipated scope of Senator Garn's exemption. It is highly unlikely that Congress intended that CEBA would reaffirm and strengthen

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[15] Wilmarth, *supra* note 6, at 4-10.

[16] Arthur E. Wilmarth, Jr., "The OCC's and FDIC's Attempts to Confer Banking Privileges on Nonbanks and Commercial Firms Violate Federal Laws and Are Contrary to Public Policy," 39 *Banking & Financial Services Policy Report* No. 10 (Oct. 2020), at 1, 6, https://ssrn.com/abstract=3750964.

[17] Wilmarth, *supra* note 6, at 2-3; *see also* Mindy West, "The FDIC's Supervision of Industrial Loan Companies: A Historical Perspective," *Supervisory Insights* (Fed. Deposit Ins. Corp., Summer 2004), at 7-9, https://www.fdic.gov/bank-examinations/fdics-supervision-industrial-loan-companies-historical-perspective.

[18] Wilmarth, *supra* note 6, at 3; West, *supra* note 17, at 9.

[19] Wilmarth, *supra* note 6, at 3 (quoting Senate Report No. 100-19 (1987) at 2, 8, 9, reprinted in 1987 U.S. Code Cong. & Ad. News 492, 498, 499).

[20] *Id.* at 3, 15 n.19.

the policy of separating banking and commerce by closing the nonbank bank loophole while, at the same time, undermining and weakening that policy by adopting Senator Garn's exemption for industrial banks. The implausibility of such a self-contradicting purpose is heightened by the absence of any evidence indicating that Congress expected that Senator Garn's exemption could be used to break down the barrier between banking and commerce.[21] Indeed, the first acquisition of an FDIC-insured industrial bank by a commercial firm did not occur until 1988, the year after CEBA was enacted.[22]

In 1999, Congress reinforced the policy of separating banking and commerce by passing a statute that prohibited further acquisitions of FDIC-insured savings associations by commercial firms. In view of Congress's powerful expressions of support for the policy of separating banking and commerce in both 1987 and 1999, the unexplained text of Senator Garn's exemption should not be applied in a way that undermines that policy.[23]

In 2005, Walmart, the largest U.S. retailer, applied to acquire (and obtain deposit insurance for) a Utah industrial bank. Walmart's application triggered widespread public opposition and led to an extensive public debate about the desirability of allowing large commercial firms to acquire industrial banks. During one of the FDIC's public hearings on Walmart's application in April 2006, Senator Garn, the sponsor of the industrial bank exemption who left the Senate in 1993, 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."[24]

Given Congress's repeated actions to uphold and strengthen the policy of separating banking and commerce, the FDIC acted properly when (1) it did not approve Walmart's application to acquire an FDIC-insured industrial bank, (2) it imposed a moratorium on acquisitions of FDIC-insured industrial banks by commercial firms in June 2006, and (3) it extended that moratorium for another year in January 2007. The FDIC also acted correctly in June 2008 when it approved deposit insurance for CapitalSource, a California industrial bank. The FDIC imposed restrictions on CapitalSource's parent companies that allowed them to engage "only in financial activities" and required them to divest any "non-conforming [commercial] investments" within one year. The CapitalSource order was the FDIC's last approval of deposit insurance for an industrial bank until it approved applications by Square and Nelnet in 2020.[25]

Allowing commercial firms to acquire industrial banks would provide significant and unwarranted competitive advantages to those firms by giving them access to the federal safety net for insured depository institutions. In addition to the low-cost funding provided by FDIC-insured deposits, commercial owners of industrial banks would receive "catastrophe insurance" in the form of access to the Fed's discount window and other sources of expected federal support during future systemic crises, as shown by the massive bailouts that the federal government provided to GMAC, GE Capital, and CIT in 2008 and 2009. Thus, allowing commercial firms to acquire industrial banks would create a highly skewed playing field, favoring large commercial enterprises that could afford to make the necessary financial commitments to acquire industrial banks while handicapping smaller firms that could not do so.[26]

Allowing acquisitions of industrial banks by Big Tech firms—especially the dominant group of Big Tech giants consisting of Alphabet (Google), Amazon, Apple, Meta (Facebook), and Microsoft—would fundamentally change our financial system and economy in ways that would be very harmful to

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[21] *Id.* at 3.
[22] West, *supra* note 17, at 9.
[23] Wilmarth, *supra* note 6, at 3.
[24] *Id.* at 2-3 (quoting Senator Garn's testimony at the FDIC's public hearing).
[25] *Id.* at 1, 3-4, 6, 11, 13, 14, 14 n.4.
[26] Wilmarth, *supra* note 16, at 9-10.

consumers, businesses, and communities.[27] The Department of Justice and the Federal Trade Commission have sued four Big Tech giants for various anticompetitive actions that have injured consumers and businesses, and a federal judge recently ruled that Google has unlawfully monopolized the online search market.[28] Permitting Big Tech firms to acquire FDIC-insured industrial banks would enable them to extend their dominant market power into the financial services sector.

Big Tech firms already enjoy significant technological advantages over traditional banks in the fields of automation, artificial intelligence, data management, data analytics, and mobile payments. As an important point of comparison, China's two leading Big Tech firms—Alibaba/Ant Group (controlling Alipay and MYBank) and Tencent (controlling WeChat Pay and WeBank)—expanded their offerings of financial services very rapidly after 2008 and built dominant consumer and retail financial franchises in China. The Chinese government responded in 2020 by cracking down on those firms and requiring them to establish separate and regulated financial holding companies for their financial activities. The meteoric rise of China's two leading Big Tech firms in China's consumer and retail financial markets prior to 2020 indicates that U.S. Big Tech giants could potentially dominate major segments of the U.S. financial industry if those firms are allowed to acquire industrial banks and extend their technological advantages and market power into the financial services marketplace.[29]

Acquisitions of industrial banks by Big Tech firms would present a wide array of public policy issues, including concerns about unfair competition, exploitation of customer financial data, violations of customer privacy, and systemic risks resulting from ownership of FDIC-insured banks by giant technology firms. The combination of Big Tech companies' massive datasets of consumer preferences and purchases with the extensive consumer financial information compiled by FDIC-insured industrial banks would greatly expand the reach of Big Tech firms into consumers' finances by giving them greater insight into household income and spending patterns and would allow the combined firms to more fully exploit such data for commercial purposes while undermining consumer privacy.[30] Further, Big Tech firms could condition or preference access by consumers and merchants to their digital commercial platforms or rewards programs on the willingness of those customers to use the financial services of their captive or shell industrial banks. Allowing a Big Tech firm to link its commercial platform with an industrial bank would allow the Big Tech firm to combine customer and merchant data to set bespoke, higher prices on transactions in the form of first-degree price discrimination that would benefit the platform while extracting unfair surplus value from consumers and merchants.[31] The BHC Act prohibits banks from processing, storing, or sharing data that is not "financial, banking, or economic" if that nonbanking data processing, storing, and transmission revenues exceed 49 percent of the bank's total revenues,[32] which would likely be the case with Big Tech shell or captive industrial banks.

Acquisitions of industrial banks by Big Tech firms would also generate intense political pressure on Congress to repeal the BHC Act's restrictions on joint ownership of banks and commercial firms. Big Tech firms would not be satisfied with making "toehold" acquisitions of industrial banks. They would push to build a bigger competitive presence in the U.S. financial industry by acquiring full-service

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[27] *Id.* at 9-11; Wilmarth, *supra* note 6, at 10.
[28] Elaine McArdle, "(Anti)Trust Issues," *Harvard Law Bulletin* (Fall 2024), https://hls.harvard.edu/today/antitrust-issues.
[29] Wilmarth, *supra* note 16, at 9-11. For discussions of the rapid expansion of China's Big Tech firms within China's financial sector and the Chinese government's regulatory crackdown in 2020, see Kathryn Petralia, Thomas Philippon, Tara Rice, & Nicolas Véron, *Banking Disrupted? Financial Intermediation in an Era of Transformational Technology* 25–38, 44–82 (Geneva Reports on the World Economy 22, 2019), https://www.cimb.ch/uploads/1/1/5/4/115414161/geneva22.pdf; Christine Menglu Wang & Douglas W. Arner, "Bigtechs and the Emergence of New Systemically Important Financial Institutions: Lessons from the Chinese Experience" (July 10, 2024), https://ssrn.com/abstract=4890458.
[30] Alexander, Laura. American Antitrust Institute. "Privacy and Antitrust at the Crossroads of Big Tech." December 16, 2021, at 17.
[31] Kechelek, Douglas M. "Data mining and antitrust." *Harvard Journal of Law & Technology*. Vol. 22, No. 2. Spring 2009.
[32] 12 C.F.R.§225.28(b)(14).

commercial banks. Conversely, large commercial banks would argue that Congress must create a "level playing field" that would allow commercial banks to acquire technology firms. Thus, allowing Big Tech firms to acquire industrial banks would probably lead to federal legislation allowing unrestricted combinations between giant technology firms and major banks. Such combinations would magnify the problems our nation already faces due to excessive levels of concentration and market power in our banking and information technology sectors as well as the dangerous political and regulatory influence that our technology giants and largest banks currently command and exploit.[33]

The emergence of embedded finance represents a secular shift to new forms of combinations that threaten to undermine the separation of banking and commerce.

Embedded finance is the integration of digital banking into non-financial companies' business platforms.[34] In embedded finance, nonbanks perform banking activities. Most often, they facilitate payments and take deposits, but in some cases, there are combinations that also make loans.

Embedded finance presents the same concerns as those in settings where commercial firms use a financial charter to conduct non-digital activities. For example, if a car dealer relies on a captive finance arm to provide financing to its customers, is this not the same as when a nonbank whose primary purpose it to serve small businesses with a point-of-sale merchant acceptance service then uses that data to underwrite merchant cash advances, and through a closed-loop ecosystem, and in ways that further bind the small business to continue to use the point-of-sale service as long as it has a loan? Does this not raise concerns for privacy and present risks to competition?

Today, the most comm embedded finance structures use application programming interfaces (APIs) to permit customers to load funds from a network-branded card into an escrow account associated with a specific merchant. When loaded, those funds leave an insured ecosystem and shift to one whose liabilities are solely held against the commercial firm. Consumer funds are deposited at a bank in the name of the commercial firm. Obtaining an industrial bank charter would permit automated clearing house (ACH) transfers of funds – further benefiting a commercial firm by lowering its interchange expenses – with no meaningful benefit to consumers.

In addition to point-of-sale services that also offer loans and payment apps inside consumer rewards accounts, another use case would be for an online merchant platform to build a buy now pay later (BNPL) service. A recently filed industrial bank charter application proposed to issue credit and debit cards to its shopping portal customers. BNPL financing would permit a sales platform to evade interchange, derive more consumer data, earn revenue from penalty fees, and further differentiate itself from other shopping platforms.

One of the largest payment app services now holds almost $40 billion of customer funds in uninsured accounts.[35] This firm is currently rolling out its own branded stablecoin as well as a new payment tool that will permit it to expand from online carts to point-of-sale swipes using a digital wallet. This firm also offers point-of-sale financing. This new service is another example of a nonbank performing a bank

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[33] Wilmarth, *supra* note 6, at 10; Wilmarth, *supra* note 16, at 9-11.

[34] PricewaterhouseCoopers. "What Does Embedded Finance Mean for Business?" *Tech Translated* (blog), May 25, 2023. https://www.pwc.com/gx/en/issues/technology/tech-translated-embedded-finance.html.

[35] Nonbank firms that accept and hold customer funds as uninsured customer balances, and allow customers to transfer those funds to third parties, appear to be engaging in the business of accepting deposits without being chartered or regulated as depository institutions, thereby violating 12 U.S.C. § 378(a)(2). Arthur E. Wilmarth, Jr., "It's Time to Regulate Stablecoins as Deposits and Require Their Issuers to Be FDIC-Insured Banks," 41 *Banking & Financial Services Policy Report* No. 2 (Feb. 2022), at 1, 2-4, 7-9, https://ssrn.com/abstract=4000795; Arthur E. Wilmarth, Jr., "PayPal's stablecoin plan poses a grave threat to financial stability," *American Banker* (Aug. 21, 2023), https://www.americanbanker.com/opinion/paypals-stablecoin-plan-poses-a-grave-threat-to-financial-stability (available on Westlaw at 2023 WLNR 28787220).

activity, and the scope of its operations underscores the ramifications to the economy of potential weakness in its corporate parent.

Currently, only one industrial bank has used its charter to build a private captive payments ecosystem, but it is reasonable to imagine that future applications will be made by firms seeking to embed an industrial bank charter inside their commercial and payments services. If a future applicant received a charter to do so, it would experience many benefits. Presumably, the successful applicant could avoid interchange costs on transfers of funds, for example, or use its platforms to derive lead generation revenue (selling coffee machines from an app to coffee customers). The ability to gain full access to the Fed's payments systems for banks increases the attractiveness of an industrial bank charter to retailers, as Walmart's failed charter application demonstrated. Additionally, as shown above, an industrial bank charter would significantly lower a commercial firm's funding costs and present new opportunities to harvest consumer data.

The rapid proliferation of embedded finance business models has underscored the urgency for the FDIC to increase its scrutiny and skepticism regarding new applications for shell or captive industrial banks, as contemplated by the FDIC's proposed rule.

The FDIC should adopt a rebuttable presumption against approving applications involving industrial banks controlled by companies that are not "predominantly engaged in financial activities."

In view of the longstanding U.S. policy of separating banking from commerce and the additional public policy considerations set forth above, the FDIC should establish a rebuttable presumption against approving applications involving industrial banks controlled by parent companies that are not "predominantly engaged in "financial activities," as defined in 12 U.S.C. § 5311(a)(6). Under Section 5311(a)(6), companies are "predominantly engaged in financial activities" if they derive at least 85 percent of their gross revenues or 85 percent of their consolidated assets from subsidiaries that are engaged in "financial in nature" activities, as defined in 12 U.S.C. § 1843(k). Companies that are not "predominantly engaged in financial activities" would include Big Tech firms and other commercial enterprises.

Our proposed rebuttable presumption would place a very strong burden of persuasion on Big Tech firms and other commercial enterprises that seek to acquire control of FDIC-insured industrial banks. Such a rebuttable presumption would be consistent with the policy that the FDIC followed between 2006 and 2020, when the FDIC did not approve any applications for deposit insurance filed by industrial banks that were controlled by commercial firms.[36] To implement our proposed rebuttable presumption, the FDIC should insert the following new subparagraph in 12 C.F.R. § 354.(a): "(8) The fact that the parent company or other covered company is not 'predominantly engaged in financial activities' as defined in 12 U.S.C. 5311(a)(6)." In addition, the FDIC should adopt the following new paragraph to be designated as 12 C.F.R. § 354(d):

"(d) *Rebuttable presumption for a parent company not 'predominantly engaged in financial activities'*— (1) *Presumption*. The parent company of the industrial bank either is not or will not continue to be 'predominantly engaged in financial activities' as defined in 12 U.S.C. § 5311(a)(6). To avoid this presumption, each Covered Company of the industrial bank must provide a written commitment pursuant to § 354(a) stating that it is and will continue to be a company that is 'predominantly engaged in financial activities' as defined in 12 U.S.C. § 5311(a)(6).

"(2) *Impact of the presumption*. The FDIC will presume that the fact that the parent company either is not or will not continue to be 'predominantly engaged in financial activities' as defined in 12 U.S.C. §

[36] Wilmarth, *supra* note 6, at 2-4, 11, 13-14.

5311(a)(6) weighs heavily against favorably resolving one or more applicable statutory factors related to the proposal for the industrial bank.

"(3) *Rebuttal of presumption*. The FDIC will afford any company seeking to rebut the presumption in this paragraph (d) an opportunity to present its views in writing. While the FDIC is considering any such materials, the FDIC will suspend consideration of any related filings, time periods will be tolled, and transactions will not be consummated."

Our proposed rebuttable presumption would enable the FDIC to disapprove applications for industrial banks by Big Tech firms and other commercial enterprises unless (1) a commercial firm makes a compelling showing that its proposed acquisition of control of an FDIC-insured industrial bank would be consistent with the public interest considerations and other statutory factors that the FDIC must evaluate under relevant statutes such as 12 U.S.C. §§ 1815, 1816, 1817(j), and 1828(c), and (2) the FDIC determines that the proposed acquisition would not threaten to undermine our nation's longstanding policy of separating banking and commerce and would not threaten to create (A) a hazardous concentration of economic and financial power and political influence, (B) toxic conflicts of interest that would seriously impair the ability of the industrial bank to act objectively in providing credit and other financial services, and (C) serious risks of systemic contagion between the financial and commercial sectors of our economy, which could inflict substantial losses on the federal "safety net" for banks.

The most straightforward and effective way for the FDIC to uphold the longstanding U.S. policy of separating banking and commerce would be to adopt a regulation providing that the FDIC will not approve applications involving industrial banks controlled by companies that are not "predominantly engaged in financial activities."

The most straightforward and effective way to uphold our nation's long-established policy of separating banking and commerce would be for the FDIC to reaffirm the policy and practice it followed between 2006 and 2020. During that period, as discussed above, the FDIC did not approve any applications by commercial firms to acquire FDIC-insured industrial banks. The FDIC should reaffirm that policy and practice by adopting a regulation providing that the FDIC will not approve applications involving industrial banks controlled by companies that are not "predominantly engaged in financial activities" as defined in 12 U.S.C. § 5311(a)(6). That approach should be implemented by amending 12 C.F.R. § 354.4(a) to require the following additional written commitment:

"(9) Submit to the FDIC a written commitment stating that the Covered Company is, and will continue to be, 'predominantly engaged in financial activities' as defined in 12 U.S.C. § 5311(a)(6)."

The foregoing written commitment would maintain an effective separation between banking and commerce. It would also protect the DIF from the very significant risks created by combinations between FDIC-insured industrial banks and commercial enterprises. It would further prevent Big Tech firms from entering the banking business and posing unacceptable threats to consumer welfare and financial stability.

IV. Shell and captive industrial banks' narrow offerings of credit and deposit services raise serious concerns about their ability to meet the convenience and needs of the communities they are obligated to serve.

Banks play a critical economic function and are chartered to serve a public purpose by meeting the convenience and needs of all communities they are established to serve. Shell or captive industrial banks that primarily service the business lines of their parents or affiliates do not offer banking products or services to the general public. The Community Reinvestment Act (CRA (12 U.S.C. §§ 2901-08), establishes an affirmative obligation for all FDIC-insured industrial banks to meet the convenience and

needs of the communities where they do business. The FDIC's regulations under the CRA make clear that the "entire community" served by an FDIC-insured industrial bank includes households, small businesses, small farms, and community development organizations located in the metropolitan areas where that bank takes deposits. Prudential regulators examine financial institutions for their lending, community investment, and related services in these areas. *See* 12 C.F.R. § 345.16 and other provisions of 12 C.F.R. Part 345, Subparts B & C.

While industrial banks are subject to community reinvestment obligations, in practice, they are held to lower standards than most other FDIC-insured depository institutions.

Industrial banks receive a special exemption from community reinvestment obligations. Unlike other financial institutions with CRA duties, parent companies whose subsidiary industrial banks have received a less-than-satisfactory grade on their most recent CRA performance evaluation are still permitted to commence new activities.[37] In contrast, the parent bank holding company of any FDIC-insured bank that receives either a "needs to improve" or "substantial non-compliance" is prevented from becoming a financial holding company or from commencing new activities that are authorized for financial holding companies.[38]

Industrial banks frequently do not support the convenience and needs of the communities where they accept deposits.

Most industrial banks operate nationally but classify their deposit-taking activities as taking place within a single geographic location where their main office is located. Sometimes, the "main office" or "branch" of an industrial bank is an office inaccessible from the street. In its public file, the industrial bank TAB Bank notes that it does not have a bank lobby open to the public, does not solicit walk-in business, does not offer a branch, teller, or an ATM, and only permits customer communication through interactive voice response phone calls, online, or by mail.[39]

Most industrial banks do not favor the credit and investment needs of the communities where they accept deposits above the needs of other communities where they do not accept deposits. For many industrial banks, "community" is a word without a practical meaning.

In practice, credit and deposit service activities offered by most industrial banks are nationwide in scope and are not focused on the local communities they are obligated to serve.

Many industrial banks have a nationwide focus. In its performance evaluation (PE), TAB Bank (TAB) comments that its "business focus is to provide niche financing to "small- and medium-sized businesses including commercial, account receivable (factoring), commercial equipment, working capital, and truck and trailer purchase programs."[40] Until its most recent PE in 2022, TAB Bank had received "outstanding" ratings on its three previous PEs. In its 2024 strategic plan, TAB Bank acknowledged the challenges it faces in meeting the credit needs of its community:

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[37] West, *supra* note 17, at 7 (table 2).
[38] *See* 12 U.S.C. §§ 1843(l)(2) & 2903(c).
[39] King, Kenneth, and Benjamin Kotter. "TAB Bank Community Reinvestment Public File." Community Reinvestment Act Performance Evaluation. Ogden, Utah, July 2024. https://www.tabbank.com/wp-content/uploads/2024/07/TAB-Bank-CRA-Annual-Public-File-2024-03.pdf.
[40] Federal Deposit Insurance Corporation. "Public Disclosure: Community Reinvestment Act Performance Evaluation for Transportation Alliance Bank., d/b/a TAB Bank." Performance Evaluation. Division of Depositor and Consumer Protection, April 13, 2022. https://crapes.fdic.gov/publish/2022/34781_220413.PDF.

> A substantial majority of the Bank's small business loans are outside its assessment area. The Bank serves small to mid-sized businesses, offering financial products and services to provide and manage working capital. The expertise of the Bank has been in the transportation industry, specifically in the over-the-road transportation industry. Also, the Bank is primarily a lending institution that does not have the traditional deposit base that competitors use to draw upon for making loans.
>
> With a narrow scope serving a specific industry and limited lending product offerings coupled with a higher cost of funds compared to its competitors, the Bank is limited in its opportunities to serve and compete in its assessment area. As the Bank continues to expand its product offerings, there will be more opportunity to expand in the local market.

TAB's strategic plan confirms the reasoning put forward by the FDIC in its proposed rulemaking. First, TAB's plan supports the FDIC's determination that an industrial bank with a narrow or captive business model is likely to face significant challenges in meeting the convenience and needs of consumers, small businesses, small farms, and community development organizations in its assessment area. Second, in discussing TAB's higher cost of capital, TAB's strategic plan reveals how an industrial bank may be disadvantaged relative to local community banks in providing any significant benefits to the community where it is located. Lastly, TAB's plan points to the fact that a shell or captive industrial bank would have to expand its credit offerings and investments to meet community needs effectively.

Unfortunately, TAB Bank's strategic plan points to another problem. Many industrial banks have moved away from their chartered purpose into high-risk areas of business that create conflicts between the bank's profit motives and consumer welfare.

The FDIC should strengthen the proposed rule to clarify that shell or captive industrial banks must meet the convenience and needs of their communities. The proposed rule states that an industrial bank that "would serve *only* as a funding channel for an existing parent company or affiliate business line" (emphasis added) would be presumed to be a shell or captive that would "weigh heavily against" favorable consideration.[41] Hypothetically, the use of the word "*only*" suggests that industrial banks that received 95 percent of their business through their parent (and met the other tests of standalone independence and viability) would not be considered a shell or captive and that dedicating 5 percent (or even half a percent) of their business to serving the general public might satisfy the convenience and needs test. The FDIC should modify the proposed rule §354.6(c)(1)(iii) to read "would serve *primarily* as a funding channel for an existing parent company or affiliate business line."

Some industrial banks have strayed from their mission and offer damaging high-cost credit to vulnerable consumers and small business owners.

Prior performance evaluations of several industrial banks have identified serious shortcomings in their community reinvestment programs. Those industrial banks have ignored the qualitative nature of their lending. In some cases, their targeted customers and service areas have strayed wildly from the original business plans set forth in their charter applications. For example, in 2022, the performance evaluation for TAB Bank identified six strategic partners by name. TAB Bank's examiners acknowledged that three of those six strategic partners facilitated subprime credit, but the examiners did not undertake a more extensive analysis to evaluate the highly problematic record of the credit products offered by those partners. One partner makes loans with effective annual percentage rates of almost 200 percent, for

[41] 12 C.F.R. §354.6(c)(1)(iii) and (c)(2). 89 Fed. Reg. at 65568.

example. TAB Bank's nonbank strategic partners rely on TAB Bank's ability to export loans to other states with unlimited interest rates under Utah law where applicable state usury laws would otherwise make it impossible for those nonbank partners to make such loans directly.

TAB Bank is not an isolated exception. First Electronic Bank (FEB) is owned by Fry's Electronics, a consumer electronics retailer, and FEB partners with two high-cost nonbank lenders: Personify Financial and OppFi. Personify offers installment loans for between $500 and $10,000 with effective annual interest rates as high as 179.99 percent. OppFi originates installment loans of between $500 and $4,000 with effective annual interest rates as high as 160 percent.[42] In each case, these loans are offered in states where usury caps would prevent nonbanks from offering credit with those rates. Rather than serving their local communities, industrial banks such as TAB and FEB facilitate dangerous high-cost loans to vulnerable consumers and small business owners.

Shell and captive industrial banks are designed to serve narrow audiences targeted by their parent companies and are not structured to meet the convenience and needs of the communities where they do business. We strongly support the FDIC's proposal to apply enhanced scrutiny to the ability of shell and captive companies to meet the convenience and needs of the communities they are obligated to serve.

When an industrial bank is structured to serve the credit needs of its parent company or affiliates (or their customers or counterparties) exclusively or predominantly, that industrial bank will find it extremely challenging to meet the community reinvestment goals required of all FDIC-insured depositories. Despite those challenges, under the current policy framework, a shell or captive industrial bank can still qualify to receive the privilege of deposit insurance. This contradiction exposes a disconnect between community reinvestment and private corporate privilege that should be rectified.

Many shell and captive industrial banks serve narrowly targeted markets that make it virtually certain that those banks will not meet the needs of any member of their local community outside of the customers and affiliates of their corporate parents. For example, one of the largest industrial banks, which is controlled by Toyota, only provides banking services to Toyota's car dealerships, car dealership executives, and their families. While Toyota's industrial bank offers home mortgages, it does so only for Toyota's car dealership executives and their families and only as part of its corporate executive relocation program.[43] In 2024, Toyota's industrial bank received an "outstanding" CRA performance evaluation. That coveted rating was awarded even though 98.3 percent of the dollar volume of loans made by that bank were through the SBA Paycheck Protection Program, and its community development lending included loans made outside of its assessment area.

Other existing industrial banks that predominantly engage in lending to business sectors or geographic areas related to their parent company have a similarly narrow focus. The limited markets they serve have little or no connection to the needs of the local communities where they solicit and accept deposits.

The FDIC should require public hearings for all applications by industrial banks to obtain deposit insurance as well as applications involving mergers, charter conversions, and changes in control of industrial banks. Conducting hearings in local communities to identify the convenience and needs of the local community where the applicant industrial bank proposes to solicit and accept deposits, or already engages in a deposit-taking business, should be a necessary step for approving any such applications.

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[42] National Consumer Law Center. "High-Cost Rent-a-Bank Loan Watch List," September 26, 2024. https://www.nclc.org/resources/high-cost-rent-a-bank-loan-watch-list/.

[43] Toyota Financial Services Savings Bank. "Community Reinvestment Act Public File for Toyota Financial Savings Bank." Public File, May 28, 2024. https://www.toyotabank.com/content/dam/tmcc-tfsb/pdfs/CRA%20Public%20File%20-%20Toyota.pdf.

For the above reasons, we strongly support the FDIC's proposal to apply enhanced scrutiny to the ability of shell and captive industrial banks to meet the convenience and needs of the communities they are obligated to serve.

Conclusion

Thank you for the opportunity to comment on this proposed rule.

We strongly support the FDIC's proposed amendments to 12 C.F.R. Part 354 with the additional revisions recommended above. We agree that Part 354 should be amended to address the risks of industrial banks and their parent companies with greater clarity and specificity. We also strongly support the FDIC's essential insight underlying this proposal—namely, that shell and captive industrial banks pose special risks that require additional regulation and warrant a rebuttable presumption against approving industrial bank transactions that are designed to create shell or captive business models.

Respectfully,

Consumer Federation of America
Arthur E. Wilmarth, Jr., Professor Emeritus of Law, George Washington University Law School
Americans for Financial Reform Education Fund
Center for Responsible Lending