January 22, 2024

Dear Senator:

The National Association of Industrial Bankers,[1] the Utah Bankers Association,[2] the Nevada Bankers Association,[3] and the American Financial Services Association[4] strongly oppose S. 3538, the misnamed *Close the Shadow Banking Loophole Act*, introduced late last year, which would have the consequence of eliminating credit and financing options for consumers and small businesses who are not otherwise served by the U.S. financial system. It would eliminate the Industrial Loan Company (ILC) industry, forcing the divestiture or liquidation of existing ILCs, and prevent the creation of any new ILCs. There is no good (let alone rational) answer to the question "what problem is the bill attempting to fix?" Therefore, we urge you to oppose S. 3538.

There are two indisputable facts that encapsulate the matter:

- ILCs are the intentional creation of federal statute: not the result of a "loophole," and
- ILCs are highly regulated by federal and state agencies.

ILCs are among the safest and soundest banks in the U.S. financial system; are well regulated by federal and state banking agencies; and comply with all safety and soundness, operational, lending, data privacy, and consumer protection laws and regulations. ILCs are very important to the customers they serve and represent only 25 institutions and one percent of domestic banking assets.

Opposition to ILCs comes from some incumbent financial institutions looking and given the absolute lack of historic safety and soundness concerns, this raises some very troubling anti-competitive concerns that would have the impact of stifling competition and innovation in the provision of banking services to consumers. These institutions are pushing a false narrative that "Big Tech" will use the ILC charter to access the insured depository sector of financial services, creating systemic risks to the financial system and potentially anti-consumer behavior.

We ask you to examine and consider the facts about ILCs presented below. We are confident that you will agree that S. 3538 is punitive, overreaching, and unnecessary legislation that will harm consumers and small businesses and eliminate innovation in the provision of financial services.

[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. National Association of Industrial Bankers (NAIB) members are chartered in California, Nevada and Utah.

[2] The Utah Bankers Association (UBA) is the professional trade association for Utah's commercial banks, savings banks and industrial banks. Established in 1908, the UBA serves, represents and advocates for the interests of its members, enhancing their ability to be preeminent providers of financial services.

[3] Nevada Bankers Association (NBA) is the united voice of Nevada's diverse banking industry: our members are dedicated to providing the best financial products, services and resources to drive and support economic growth, job creation and prosperity throughout the state of Nevada.

[4] Founded in 1916, the American Financial Services Association (AFSA) is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.

I. ILCs are an intentional creation of Congress, not a loophole.

S. 3538 and its supporting materials erroneously assert 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). The exemption did not in any way erode the meaningful application of existing safety and soundness regulations, it was simply a decision of policy makers to affirmatively create a path for certain industrial entities to deliver much needed financial services through the safety of a bank. This is good for consumers and maintains historic prohibitions against any practice that would mix banking and commerce.

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. Congress has 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 BHCA. The moratorium specified in the Dodd-Frank Act also required the Government Accountability Office 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.

II. ILCs are highly regulated by federal and state regulators.

S. 3538 and its supporting materials incorrectly assert 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 the testimony of FDIC Chairman Martin Gruenberg 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.

III. Recent Rulemaking ensures 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, as implemented through the Federal Reserve Board's Regulation W, to ensure that the ILC and its parent company interact in a safe and sound manner in compliance with the applicable law and regulation. The regulators oversee compliance management systems of ILCs to address affiliate transactions. The regulators can also require that the parent company 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 FDIC Chairman Gruenberg has noted in Congressional testimony, 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.

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

A review of the history of ILCs clearly and unequivocally demonstrates spurious nature of the allegations 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 (especially commercially owned ILCs), are better capitalized, have a higher return on assets (ROA), and are generally more profitable than banks in general.[5]

As of September 30, 2023, the U.S. banking industry had $23.6 trillion in assets and $2.2 trillion in capital, resulting in a capital-to-assets ratio of 9.2%. ILCs have $238 billion in assets and capital of $23.6 billion, resulting in a capital-to-assets ratio of 9.9%.

For the quarter ending September 30, 2023, the banking industry reported net income totaling $71.6 billion, resulting in an annualized return on assets (ROA) of 1.21 percent. ILCs' net income for the period totaled $1.59 billion, resulting in an annualized ROA of 2.68 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.

Furthermore, of the $23.6 trillion in total banking assets as of September 30, 2023, ILCs account for only $238 billion, only 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.

V. Leading academic research supports ILC safety and soundness regulation.

Renown scholars Drs. James R. Barth and Yanfei Sun released a comprehensive study on ILCs.[6] After an exhaustive review of data, Drs. Barth and Sun documented the following:

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;" and
3. "Nor do we find that [ILC] bank holding companies are more likely to contribute to financial instability than bank holding companies."[7]

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

---

[5] *Industrial banks: Challenging the Traditional Separation of Commerce and Banking*. Barth, James R. and Yanfei Sun. Aug. 2020. Available at:https://doi.org/10.1016/j.qref.2019.10.001.

[6] *Source of Strength and Consolidated Supervision: A Comparative Assessment of Industrial Banks and Commercial Banks*. July 2021. Available at: https://d30i16bbj53pdg.cloudfront.net/wp-content/uploads/2021/07/2021-Barth-Analysis-Final-071521.pdf.

[7] *Ibid.*

insured by the FDIC. Nothing in the history of ILCs provides any basis to argue that they present a significant risk to the FDIC, the banking industry, or the nation's economy.

VI. 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" getting into banking.[8] The concern with "Big Tech" entering financial services is understandable.; but the existing laws makes such steps impractical for many of these companies. For instance, Sections 23A and 23B of the Federal Reserve Act, as implemented by Regulation W, impose restrictions on banks (including ILCs) lending to, purchasing assets from, and engaging in certain other transactions with affiliates. In addition, 23B requires all transactions to be on "market terms" and documented for compliance with the requirements of Regulation W.

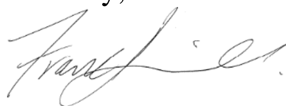
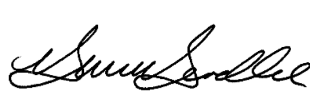
The FDIC and other federal bank regulators have the authority and the experience in dealing with anticompetitive behavior through the Bank Merger Act. The Bank Merger Act requires the federal banking agencies to consider whether a proposed merger would create a monopoly or lessen competition in any market. These standards allow the federal banking regulators to review the competitive implications of any proposed "Big Tech" acquisition of any insured depository institution including an ILC.

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.

VII. Conclusion: *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. They are subject to all banking regulations including safety and soundness, data privacy, operational risk, and consumer protection. They provide critical financial services to the customers they serve. We ask you to look at the facts, which make clear that ILCs themselves are not a threat but are, in fact a significant benefit to the banking system, the U.S. economy, small businesses, and consumers. We are willing to work with Congress on legislation that mitigates the risk of "Big Tech" obtaining any type of bank charter, if that is a concern. Thank you for your time and consideration.

Sincerely,

Frank R. Pignanelli
Executive Director
NAIB
frank@industrialbankers.org
(801) 558-3826

Howard Headlee
President
UBA
hheadlee@uba.org
(801) 364-4303

Bill Himpler
President & CEO
AFSA
bhimpler@afsamail.org
(202) 466-8616

Phyllis Gurgevich
President
NBA
phyllis@nvbankers.org
(702) 233-8607

---

[8] *BigTech in Finance*. Financial Stability Board, December 9, 2019. Available at: https://www.fsb.org/2019/12/bigtech-in-finance-market-developments-and-potential-financial-stability-implications/.