

Overview

Industrial loan companies (ILCs) or industrial banks (IBs) (together, “ILCs”) typically enjoy the privileges of traditional banks but pose two significant risk factors unique to ILCs:

- (1) they are not subject to the Federal Reserve’s supervision, which occurs at the consolidated level (i.e., the ILC’s parent company, the ILC, and their affiliates); and
- (2) they permit the intermingling of commercial and financial activity, prohibited for traditional banks.

In light of these concerns, the FDIC did not permit any new ILCs for over a decade, until March of this year, when it approved two. Now, the FDIC has a proposed rule outstanding that threatens to open the floodgates to new ILC charters. New ILCs pose threats both to the financial system as a whole and to consumers, as they offer non-banks a far easier path to federal interest rate preemption than they would otherwise have—or than has even been intended under the law. The result would be an increase in high-cost predatory lending that avoids state interest rate caps and causes severe harm to consumers.

ILCs were never intended to be large national or global commercial firms exempt from consolidated supervision.

ILCs are state-chartered entities that began in the early 1900s as small, locally-focused institutions. In 1982, they became eligible for deposit insurance granted by the FDIC, which gives ILCs the interest rate privileges of traditional state-chartered banks. However, based on an exemption from the definition of “bank” in the federal Bank Holding Company Act in 1987—back when ILCs were still small, locally-focused institutions—ILCs and their owners are not subject to the consolidated supervision by the Federal Reserve to which traditional banks are subject. In addition, whereas traditional bank owners are typically prohibited from engaging in commercial activities, there is no such bar for ILCs owners.

ILCs performed poorly during the Great Recession, resulting in significant drains on the federal safety net. At least six very large corporate owners of ILCs either received huge bailouts to prevent failure (General Motors Acceptance Corp. (GMAC), Merrill Lynch, Goldman Sachs, and Morgan Stanley); had very serious liquidity problems and received extensive financial assistance from federal agencies (GE Capital); or failed, wiping out \$2.3 billion of TARP funding (CIT group).¹

ILCs have also been disproportionately involved in predatory lending. GMAC, GE Capital, and CIT Group were all engaged in predatory subprime lending leading up to the financial crisis. GE Capital’s mortgage unit was ranked 4th on the Treasury Dept.’s list of worst subprime originators. Fremont Investment and Loan was the 7th largest subprime lender, notorious for its reckless practices. It pumped thousands of toxic mortgages into the market before its parent company filed for bankruptcy in 2008. Today, ILC First Electronic Bank is engaged in a “rent-a-bank” scheme whereby it is being used by high-cost lender Personify Financial to make high-cost installment loans of \$1,000 to \$10,000 at APRs as high as 179.99% in 22 states whose laws do not allow that rate for a non-bank lender.

Today, non-bank lenders seeking easy paths to federal preemption of state interest rate caps are pushing for expansion of ILCs. Non-bank lenders, which are subject to interest rate limits in the vast majority of states, have been pushing federal regulators to find ways for them to take advantage of banks’ preemptive rights. One such way was a “fintech charter” from the OCC, but New York sued the OCC alleging the agency lacks authority to issue that

¹ Comments to the FDIC of Arthur E. Wilmarth, Jr., Professor of Law, George Washington University Law School at 18, <https://www.fdic.gov/regulations/laws/federal/2020/2020-parent-companies-of-industrial-banks-3064-af31-c-002.pdf>.

charter. A law firm that represents payday lenders recently described ILCs this way: “The [FDIC’s] proposed rule, together with the FDIC’s recent approvals of deposit insurance applications for NelNet Bank and Square Financial Services, Inc., suggest the ILC charter as a viable alternative to the OCC’s fintech charter, which has been stalled by litigation.”² The writing is on the wall: Financial companies will seek ILC charters over traditional bank charters because they want interest rate preemption without the responsibilities stemming from consolidated Fed supervision.

High-cost lending only fuels financial exclusion. We and a coalition of civil rights and consumer groups deeply object to the attempts that banking regulators, online lenders, and others make to justify bank/non-bank partnerships, or preemption of state interest limits more broadly, with claims that these are a path to a more inclusive market, particularly for communities of color. We heard the same claims about predatory subprime mortgage lending until the foreclosure crisis ravaged neighborhoods of color and only widened the racial wealth gap. The suggestion that high-cost lending offers a path toward upward mobility insults those of us who understand that our communities deserve better. High-interest loans will never “make poor people rich.”³ Nor do they help with the lack of income and assets caused by centuries of discrimination and growing inequality. Rather, predatory lending only makes poor people poorer. Adding the new label “fintech” to high-cost lending make it easier for banking regulators to justify their support, but it doesn’t soften the blow high-cost loans land on struggling families.

Now is among the worst times imaginable to disrupt longstanding safeguards that protect both the systemic health of the economy and consumers. We are in the midst of an unprecedented health crisis and a severe economic crisis, with both crises impacting communities of color more heavily than white communities. The future, on both the health and economic fronts, is profoundly uncertain. We are, at the same time, at a pivotal moment in our nation’s reckoning with its history of structural racism. Systemic racial barriers persist in virtually every sphere, and the banking and credit arenas are no exception. In fact, racist financial practices are among the most well-known and documented in the history of racial exclusion. As we reevaluate structural racism across our society, we should be critically scrutinizing the effects of financial practices, particularly as they impact Black households’ efforts to achieve financial stability and advancement. Instead, expansion of ILCs would disrupt longstanding safeguards that have played a fundamental role in protecting both our economy from systemic risk and consumers from predatory financial practices.

Congress should impose a moratorium on deposit insurance for ILC/IB charters, and the FDIC should stop approving such insurance, until ILCs are subject to the more rigorous supervision requirements of traditional banks.

² Ballard Spahr, March 25, 2020, <https://www.jdsupra.com/legalnews/fdic-issues-proposed-rule-for-approval-86042/>.

³ See, e.g., Remarks of Acting Comptroller of the Currency Brian Brooks to the Online Lending Policy Institute, June 11, 2020, https://www.youtube.com/watch?v=Ae_SoZeRbxM, at 33:00 (stating “I want to make poor people rich” while addressing financial inclusion, in a conversation where he also states that his personal belief is that “price controls generally create shortages” and that “if we believe in market pricing for hamburgers, for jeans, for automobiles, I’m not sure why we don’t believe in market rates for money; it’s another commodity, and we want it to flow freely”).