ELECTRONIC TRANSACTIONS ASSOCIATION
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December 22, 2023

The Honorable Sherrod Brown
United States Senate
Washington, DC 20510

The Honorable Chris Van Hollen
United States Senate
Washington, DC 20510

The Honorable Bob Casey
United States Senate
Washington, DC 20510

The Honorable John Kennedy
United States Senate
Washington, DC 20510

The Honorable Mike Braun
United States Senate
Washington, DC 20510

The Honorable Roger Wicker
United States Senate
Washington, DC 20510

Dear Senators Brown, Van Hollen, Casey, Kennedy, Braun, and Wicker:

On behalf of the Electronic Transactions Association (ETA), we're pleased to share our views on the *Close the Shadow Banking Loophole Act*. We're concerned that this piece of legislation will negatively impact innovation and the use of technology in financial products and services for consumers and small businesses.

ETA is the world's leading advocacy and trade association for the payments industry. Our members span the breadth of significant payments and fintech companies, from the largest incumbent players to the emerging disruptors in the U.S and in more than a dozen countries around the world. ETA members make commerce possible by processing approximately $44 trillion annually in purchases worldwide and deploying payments innovation to merchants and consumers.

Close the Shadow Banking Loophole Act

Industrial loan companies (ILC) banks are an important part of the banking system in the U.S. and their regulatory treatment was created as part of the Bank Holding Company Act (BHCA), which was enacted in 1956 to enhance competition and consumer choice.[1] Congress later redefined the term "bank" by enacting the Competitive Equality Banking Act of 1987 (CEBA).[2] CEBA largely shaped the current regulatory framework and resulting policy debates related to ILCs.

Under the CEBA, an ILC is not considered a bank if it is chartered in a state that required Federal Deposit Insurance Corporation (FDIC) insurance as of March 1987 and cannot offer demand deposits.[3] While Congress has enacted new laws addressing policy issues surrounding ILCs over the past thirty years, there have been circumspect policy decisions by lawmakers to expressly create an exemption in the law to allow for commercial ownership of banks in a small number of states subject to specific restrictions and limitations.

[1] See Bank Holding Company Act of 1956, Pub. L. No. 84-511, §§ 1-12, 70 Stat. 133 (1956) (codified at 12 U.S.C. §§ 1841 et. seq.)
[2] Pub. L. No. 100-86, § 101, 101 Stat. 552, 554 (1987). See S. Rep. No. 100-19, at 5-11
[3] 12 U.S.C. §1841(c)(2)(H)

As written, this legislation would limit ownership of ILC charter banks and place unprecedented requirements on ILC parent companies. This punitive action is unwarranted because ILCs are strong, safe, and regulated and insured by the FDIC.

The FDIC already has the authority to examine any affiliate of any ILC, including the parent company. Moreover, state regulatory authorities in California, Nevada, and Utah have the authority to conduct examinations of both the parents and affiliates of ILCs. Like ordinary banks, ILCs are subject to Sections 23A and 23B of the Federal Reserve Act, which restricts transactions among ILCs, affiliates, and parents and are prohibited from extending loans of significance to their parent or affiliates or from offering them on preferential non-market terms.[4] Additionally, the FDIC tends to impose stricter prudential standards on ILC banks – two recent approval orders set a leverage ratio of 20%[5] and 12%[6], whereas the statutory leverage ratio for ordinary banks of similar sized is 9%.[7] Similar to bank holding companies, ILC parent companies are subject to Section 38A of the Federal Deposit Insurance Act which makes sure they can act as a "source of financial strength" should an industrial bank face financial distress.[8]

Joint supervisory approach to overseeing ILCs with the FDIC and state regulators has been effective in ensuring that ILCs maintaining safe and sound capital standards as well as compliance with federal consumer protection, community reinvestment, and anti-money laundering laws.[9] These safeguards allow state and federal regulators to provide adequate oversight of ILCs. For clarity, below is a chart that compares key features of the ILC with those of a traditional bank:

Comparison of Powers Shows Key Differences between Commercial Bank and ILC Charters[10]		
Powers	**State Commercial Bank That Is a BHCA Bank**	**Industrial Loan Company (or Industrial Bank) That Is Not a BHCA Bank**
Ability to accept demand deposits	Yes	Varies with the particular state. Where authorized by the state, demand deposits can be offered if either the ILC's assets are less than $100 million or the ILC has not been acquired after August 10, 1987
Ability to export interest rates	Yes	Yes
Ability to branch interstate	Yes	Yes

[4] 12 U.S.C. §§ 371c and 371c-1
[5] FDIC, Re: Square Financial Services, Inc., Order, March 17, 2020
[6] FDIC, Re: Nelnet Bank, Order, March 17, 2020
[7] FDIC, "Community Bank Leverage Ratio Framework," Financial Institution Letters FIL-66-2019, November 4, 2019
[8] 2 U.S.C. § 371c
[9] FDIC, "Parent Companies of Industrial Banks and Industrial Loan Companies," 85 Federal Register 17771-17773, March 31, 2020
[10] https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/industrial_loans.html

Ability to offer full range of deposits and loans	Yes	Yes, including NOW accounts, but see the first entry above regarding demand deposit accounts
Authorized in every state	Yes	No. ILCs currently are chartered in seven states*
Examination, supervision, and regulation by federal banking agency	Yes	Yes
FDIC may conduct limited scope exam of affiliates	Yes	Yes
Golden Parachute restrictions apply	Yes	Yes, to the institution; no, to the parent
Cross Guarantee liability applies	Yes	No
23A & 23B, Reg. O, CRA apply	Yes	Yes
Anti-tying restrictions apply	Yes	Yes
Parent** subject to umbrella federal oversight	Yes	No
Parent** activities generally limited to banking and financial activities	Yes	No
Parent** could be prohibited from commencing new activities if a subsidiary depository institution has a CRA rating that falls below satisfactory	Yes	No
Parent** could be ordered by a federal banking agency to divest of a depository institution subsidiary if the subsidiary becomes less than well capitalized	Yes	No
Full range of enforcement actions can be applied to the subsidiary depository institutions if parent fails to maintain adequate capitalization	Yes	Yes
Control owners who have caused a loss to a failed institution may be subject to personal liability	Yes	Yes

*California, Colorado, Hawaii, Indiana, Minnesota, Nevada, and Utah.

**Parent, with respect to a state commercial bank, refers to a bank holding company or financial holding company subject to supervision by the Federal Reserve. Under a proposed rule, broker-dealers who own ILCs may soon be able to choose consolidated supervision by the Securities and Exchange Commission. See “Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities,” 62 Fed. Reg. 62872 (proposed November 6, 2003, to be codified at 17 C.F.R. Part 240).

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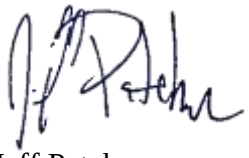
Note: NOW = negotiable order of withdrawal; CRA = Community Reinvestment Act

Given the tangible benefits of such technological advancements and the rigorous safeguards in place for ILCs, ETA urges policymakers to remain thoughtful and forward-thinking in how to best support the industry's on-going efforts to provide opportunities for all consumers to access and benefit from innovative financial products and services. Efforts by policymakers to regulate financial products and services should be done collaboratively with industry participants and with careful consideration of the many types of business models and products in the marketplace.

ETA stands willing to work with your offices and other interested parties to refine this proposal and to create a positive legislative environment. To collaboratively develop solutions that address legitimate concerns without stifling innovation, we would welcome a deeper understanding of the specific concerns the *Close the Shadow Banking Loophole Act* aims to address. If you have any questions, please contact me or ETA's Executive Vice President, Scott Talbott at stalbott@electran.org.

Sincerely,



Jeff Patchen
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Electronic Transactions Association