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Financing Fintech: What Is an ILC and Why Do You Care?

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ILC = Industrial Loan Company

- State law charter for institutions that make loans and offer deposits or investment certificates
- First established around 1910 to lend to industrial workers who could not get credit from banks
  - Sometimes called Industrial Banks, or Morris Plan Banks after first founder, Arthur Morris
- Historically few in number and limited total assets
- Currently limited to Utah, Nevada, California, Indiana, Minnesota and Hawaii
- Most ILCs are in Utah or Nevada with California in third place
  - Utah has most of the charters and more than 90% of the assets

Bank Holding Company Act Exemption

- Primary attraction of the ILC charter is that ILCs in grandfathered states are not banks under the definition in the Bank Holding Company Act
- Exemption applies to an industrial loan company or industrial bank organized under the laws of a State, which, on March 5, 1987, had in effect or had under consideration in such State's legislature a statute that required or would require such institution to obtain Federal deposit insurance and which:
  - Does not accept demand deposits that the depositor may withdraw by check or similar means for payment to third parties;
  - Has total assets of less than $100,000,000; <u>or</u>
  - Control was not acquired after August 10, 1987
- Exemption can be lost due to overdrafts at the Fed on behalf of an affiliate

Significance of the Exemption

- Parent company of the ILC can engage in commercial and other activities that are not permissible for bank holding companies and financial holding companies
- Parent company is not examined and supervised as a bank holding company
- Parent company is not subject to capital requirements that apply to a bank holding company

Why Aren’t There More?

- ILC requires a charter from the state
- ILC also requires deposit insurance from the FDIC
- ILC exemption does not permit corporate checking accounts at ILCs with assets of $100 million or more
- FDIC moratorium on applications
- FDIC request for comment – more than 10,000 comments, mostly opposing approval
- Congressional hearings
- Both applications were withdrawn
- No currently active ILCs have been established since then

Arguments against Commercial ILCs

- Mixing banking and commerce is risky
  - Bank Holding Company Act has historically separated banking and commerce
- Mixing banking and commerce spreads the deposit insurance subsidy to commercial firms
  - Commercial firms that own ILCs will have a funding advantage over competitors that do not
- Unfair competition for banks
  - Bank holding companies are prohibited from engaging in commercial activities
- Absence of consolidated holding company supervision will expose the ILCs to increased risks
- Loss of independent credit judgments

Arguments for Commercial ILCs

- Increased competition for banking services
- Additional capital to support banking activities
- Capital assurance and liquidity support agreement with the FDIC can serve as a substitute for holding company capital
- Sections 23A and 23B, which limit credit from insured banks to affiliates, limit the spread of any deposit insurance subsidy

Fintech and ILCs

- Non-bank fintech companies are already providing bank-like financial services
  - Financing
  - Payments
  - Processing
- Community Reinvestment Act issues

Path Forward?

- No legislation currently limits ILC charters
  - Up to the FDIC and the states
  - Non-commercial ILC parents do not raise all of the same issues as commercial ILC parents
- Possible 85/15 test: 85% financial and 15% commercial