ICBA
Independent Community Bankers of America®

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Preserving the Integrity of the Bank Charter: The Community Bank Perspective

The Independent Community Bankers of America, representing community banks across the nation with more than 50,000 locations, appreciates the opportunity to provide this statement for the record for today's hearing, "Banking Innovation or Regulatory Evasion? Exploring Trends in Financial Institution Charters." We appreciate the Committee raising the profile of fundamental questions that will determine the future of the American financial services landscape. We are pleased to share the community bank perspective on these critical questions.

Congress Must Assert its Authority Over the Fundamental Legal Framework of Banking

This is a time of transformative change in the financial services marketplace. Community banks welcome responsible innovation and recognize that technological change underscores the importance of a robust legal framework to ensure consumer protection as well as the safety and soundness of our institutions and of the financial system as a whole. In addition, we must not allow technological change to simply erode the long-standing U.S. policy of separating banking and commerce embodied in the Bank Holding Company Act, a policy created in the 1930s in response to concerns about concentration of economic power. Mixing banking and commerce inevitably creates market distortions and leads to cross-sector consolidation. In the age of big data, social media and e-commerce conglomerates, this threat is greater now than it was in the 1930s.

Because the legal framework of banking is fundamental and the stakes are far reaching and significant, any changes to the financial structure should be debated and deliberated in Congress, not merely through oversight but through the legislative process. Only Congress has the requisite authority as well as the power to ensure consistent regulation and oversight across charters issued by different agencies. Agencies should not infringe upon congressional authority by, for example, creating new charters and conferring new financial powers on non-depository institutions that have traditionally and with sound reason been limited. As we argue below, the Office of the Comptroller of the Currency's (OCC's) proposed fintech charter and payments charters are examples of "charter slippage" that carry harmful, unintended consequences. In addition, the industrial loan company (ILC), though not a new charter, has historically been limited and is offered by only a handful of states. A state chartered ILC has the power to operate nationwide. Prior to 2020, the FDIC had not approved deposit insurance for a new ILC for more than 10 years. As discussed below, we urge Congress to reexamine the significant risks posed by the ILC charter.

Policy Must Promote Innovation

Innovation in financial services is critical to a modern, and increasingly digital, economy. Significant financial innovation is occurring today within traditionally chartered institutions and in partnership with cutting edge technology companies. Innovation offers financial consumers the choices they have come to expect and the speed and ease of transactions that today's technology makes possible. Such innovation is also the key to the United States' international competitiveness. But we must not envision a false tradeoff between financial innovation and fundamental consumer and systemic protections. Public policy can encourage responsible innovation by creating more flexible regulation for depository institutions and ensuring a commensurate regulatory regime and oversight for entities pursuing bank charters.

Limited Purpose Charters: General Skepticism is Warranted

ICBA urges Congress to take a skeptical view of the creation of new limited purpose charters. In view of the evolution of other limited purpose bank charters—such as the ILC which is discussed more fully below—ICBA is concerned that any limited purpose fintech bank charter could end up having all of the advantages and benefits of a full-service bank charter without commensurate supervision and regulation. What begins as a narrow charter crafted to serve a particular demographic or a niche form of banking has the potential to grow and reshape the financial services landscape. Again, this potential calls for the intervention of Congress.

OCC Fintech Charter Would Distort Financial Marketplace

In 2018, the OCC indicated that it was open to accepting applications for national bank charters from non-depository fintech companies engaged in the "business of banking." While such a charter would subject online lenders and fintech companies to more oversight and regulation than they now have—particularly in the area of consumer protection—these companies would be subject only to limited safety and soundness supervision and examination and would not be subject to the Community Reinvestment Act (CRA).

A special-purpose national bank charter for fintech firms would create an unlevel regulatory playing field. By evading the fundamental precepts of bank regulation in the United States, applicants for these charters would also gain a substantial and unfair advantage over other national and state banks that operate, consistent with Federal law, as insured banks. The OCC has contemplated the possibility of a narrow purpose bank charter applicant that would not take deposits and therefore would not have FDIC insurance or meet the definition of bank. The precedent-shattering approach of granting a national bank charter to an institution that accepts only uninsured deposits would violate the Federal law, the consistently expressed intent of Congress, and public policy considerations essential to the functioning of the nation's financial system. Conversely, approving a national bank charter for such an institution would provide a new pathway to evade the comprehensive regulatory regime established by Congress for banks and their holding companies.

ICBA supports the development of a fintech regulatory framework that is no less stringent than that which applies to insured depository institutions and their parent companies. Notably, Congress must exercise its power to sets any new charter regime variants. The OCC should publish transparent capital and liquidity requirements for these firms that specifically address minimum levels considered appropriate for a fintech firm to be well capitalized. Fintech capital and liquidity requirements should be no less rigorous than those that apply to insured depository institutions. Such a framework would promote a fair regulatory system, protect consumers, and support safety and soundness at these companies.

ICBA strongly supports a District Court ruling that the National Bank Act "business of banking" clause only allows the OCC to issue charters to depository institutions. The OCC is appealing that decision to the 2nd Circuit Court of Appeals. ICBA has filed an amicus brief in support of the New York Department of Financial Services.

OCC Payments Charter Could Compromise the Federal Reserve Payments System

In 2020, former Acting Comptroller Brian Brooks announced his intent to launch a special purpose payments charter, which could be used by non-depository companies to access the Federal Reserve payments system and safety net.

The special-purpose payments charter raises many of the same concerns raised by the fintech charter. It could be used to access the Federal Reserve payment system and avoid state consumer protection laws. In addition, such a charter, which could be owned by commercial companies, would violate the long-standing principle of the separation of banking and commerce. Would the non-bank parent company of a new special purpose payments bank be subject to the Bank Holding Company Act (BHCA)? If not, the parent company would not be subject to consolidated supervision, capital and liquidity requirements, and would not be required to act as a source of strength to its subsidiary payments bank. For these reasons, the special purpose payments charter would create more risk in the Federal Reserve payments system.

Because the National Bank Act does not authorize such a charter, any changes to it should first be debated and deliberated in Congress. Without explicit authority from Congress, OCC should not proceed with the issuance of these charters.

SPDI Charters Present Novel and Heightened Risk to the Payments System

Special purpose depository institution (SPDI) charters created under state law for non-traditional financial institutions such as cryptocurrency and blockchain companies also present novel and heightened risk to the payments system. Enabling these companies to receive deposits and conduct a range of other traditional banking activities without requiring them to obtain FDIC insurance could potentially harm consumers who may believe they are afforded the same protections as a national bank. As additional states embrace cryptocurrency as a "business development gold rush" and consider legislation that would create SPDI charters for cryptocurrency companies, ICBA is concerned about potential asymmetries that would encourage risk of regulatory arbitrage. The benefits of innovation must not come at the expense of the integrity of the banking and payments systems, they must be accomplished in a manner that addresses the unique risks that these new business models may present.

The Federal Reserve Board should direct the Reserve Banks not to grant non-traditional entities access to accounts or payments services until it has adopted uniform policy governing their exercise of discretion in granting such access.

This policy, which should be developed in a transparent manner including notice and comment, should apply to requests submitted by SPDIs created under state law or through other means. Nontraditional companies seeking a federal or state charter should be subject to the same regulatory framework that applies to insured depository institutions.

Industrial Loan Companies

The ILC loophole allows commercial companies to own financial institutions that are the functional equivalent of banks and effectively mix banking and commerce.

The Dodd-Frank Act included a three-year moratorium on FDIC approval of deposit insurance for new ILCs. However, in the past year, the FDIC approved the applications of Square and Nelnet. There are currently six applications pending before the agency, including applications from Rakuten and GM Financial, each of which should raise concerns about the mixing of banking and commerce, impartial allocation of credit, consumer privacy and risk to the taxpayer. We can expect more massive technology and social media companies to seek to exploit the ILC loophole. If this exploitation is allowed, it would shift the American financial landscape and give rise to a whole new dimension of risk, a threat not only to our prosperity and economic diversity but to consumer privacy and fraud on a massive scale. What's more, commercial owners of ILCs, unlike bank holding companies, are not subject to consolidated supervision by the Federal Reserve. This constitutes a dangerous gap in financial safety and soundness oversight and new risk to the FDIC insurance fund.

ICBA strongly supports the "Close the ILC Loophole Act," sponsored by Rep. Jesús "Chuy" García, which would amend the Bank Holding Company Act to remove the exemption for ILCs from the definition of a bank with a one-year transition period, thereby permanently closing the ILC loophole.

ICBA would also support a temporary moratorium on ILC applications so that Congress can consider permanent closure of the loophole. The "Bank Charter Review Act," would create a three-year moratorium on the approval of deposit insurance applications for new ILCs and require and General Accountability Office to carry out a study of various federal and state banking charters. As you know, the Dodd-Frank Act created a three-year moratorium.

Closing

Thank you again for convening today's hearing. The questions before the committee are fundamental to the future direction of American financial services and should be exclusively within the purview of Congress not the agencies. We urge you to assert your authority over these important questions and offer to work with you to develop and advance appropriate legislation.